

No. 12664

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United States  
Court of Appeals  
for the Ninth Circuit.

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COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

GRACE H. KELHAM, LEILA H. NEILL, ELLIS  
M. MOORE, HARRIET H. BELCHER, and  
LILLIE S. WEGEFORTH,

Respondents.

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Transcript of Record

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Petitions to Review Decisions of the Tax Court  
of the United States.



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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## APPEARANCES

For Petitioner:

LEON DE FREMERY, ESQ.

For Respondent:

W. J. McFARLAND, ESQ.,

T. M. MATHER, ESQ.

Transferred to Judge Murdock 4/19/49

Transferred to Judge Turner 6/30/49



Docket No. 5333

GRACE H. KELHAM,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1944

June 12—Petition received and filed. Taxpayer notified. Fee Paid.

June 13—Copy of petition served on General Counsel.

June 12—Request for Circuit hearing in San Francisco, Calif., filed by taxpayer. 6/15/44 Granted.

July 24—Answer filed by General Counsel.

July 27—Copy of answer served on taxpayer, San Francisco, Calif.

1947

Aug. 22—Hearing set Nov. 3, 1947—San Francisco, Calif.

Nov. 3—Hearing had before Judge Tyson on merits, motion of Respondent and Petitioner to consolidate, Granted. Stip. of facts, Supplement Stip. of facts filed at hearing. Briefs 50 days; replies 40 days.

1947

Nov. 12—Transcript of hearing 11/3/47 filed.

Dec. 22—Brief filed by taxpayer. P. 12/24/47 copy served.

Dec. 23—Brief filed by General Counsel.

1948

Jan. 27—Motion for extension to Mar. 2, 1948, to file reply brief by G. C. 1/28/48 Granted.

Feb. 2—Reply brief filed by taxpayer (P). Copy served.

Mar. 9—Motion for leave to file the attached reply brief; brief lodged and filed by General Counsel. 3/10/48 Granted.

1949

Dec. 20—Opinion rendered, Judge Turner. Decision will be entered under Rule 50. Served 12/21/49.

1950

Feb. 28—Respondent's computations for entry of decision filed.

Feb. 28—Consent to respondent's computation filed (letter).

Mar. 14—Decision entered, Judge Turner, Division 8.

Mar. 17—Agreement to entry of decision under Rule 50 filed by taxpayer.

1950

June 2—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by General Counsel.

June 12—Proof of service of petition for review filed (2) on taxpayer and counsel for taxpayer.

June 29—Motion for extension of time to Aug. 31, 1950, to prepare and transmit the record filed, by General Counsel.

June 29—Order enlarging the time to August 31, 1950, to prepare and transmit the record entered.

July 26—Statement of points filed by General Counsel with statement of service thereon.

July 26—Statement re diminution of record filed by General Counsel with statement of service thereon.

The Tax Court of the United States  
Docket No. 5333

GRACE H. KELHAM,

Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (San Francisco-IRA:90D-LB) dated May 26, 1944, and as a basis of her proceeding alleges as follows:

1. Petitioner is an individual, whose mailing address is 1110 Crocker Building, San Francisco, California. The return for the period here involved was filed with the Collector for the First District of California.
2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on May 26, 1944.
3. The taxes in controversy are income taxes for the calendar year 1940 and in the amount of \$48,251.62.
4. The determination of tax set forth in said notice of deficiency is based on the following errors:

(a) The Commissioner erred in disallowing as a deduction interest paid by petitioner during the calendar year 1940 in the amount of \$5,273.73.

(b) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1940 were paid out of earnings or profits to the extent of 100% thereof, and as a result of said determination increasing petitioner's income for the year 1940 by the amount of \$91,843.20; and the Commissioner erred in failing to find that at least 79.792% of said distributions were not paid out of earnings or profits.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner deducted from gross income on line 14 of her Income Tax Return (Form 1040) for the calendar year 1940 interest in the total sum of \$8,533.24, which said total sum included interest in the amount of \$2,250.25 paid by petitioner to the Collector of Internal Revenue during the calendar year 1940, and interest in the amount of \$3,023.48 paid to the State Treasurer of the State of California during the calendar year 1940, under the circumstances hereinafter set forth.

(b) Petitioner is one of the two daughters of Grace S. Hamilton, who died on January 23, 1937, leaving an estate subject to probate with an appraised value at the date of death of \$144,429.26. The debts of decedent and administration expenses of said estate totalled \$129,006.92. Said decedent

had made transfers prior to her death of a substantial portion of her property, and the Commissioner of Internal Revenue determined that a portion of said transfers was includible in the gross estate of said decedent and subject to federal estate tax. The federal estate tax payable by the estate of said decedent, including the taxable portion of said transfers as finally determined by said Commissioner, was the sum of \$672,809.04.

(c) Petitioner and her sister were each transferees of one-half of said transfers made by said decedent prior to her death, including the taxable portion of said transfers as finally determined by said Commissioner in determining the amount of said federal estate tax as aforesaid, and petitioner as such transferee was personally liable for the payment of said tax.

(d) The federal estate tax shown to be due by the return (Form 706) filed for said estate was \$642,119.42. During the calendar year 1938 petitioner and her said sister paid to the Collector of Internal Revenue the tax shown to be due by said return in equal proportions as between themselves.

(e) During the calendar year 1940 said Commissioner determined that there was a deficiency in federal estate tax due from the estate of said decedent in the amount of \$39,270.78 and on June 18, 1940, petitioner and her said sister paid to the Collector of Internal Revenue said deficiency together with interest in the amount of \$4,500.51 in equal proportions as between themselves. Peti-

tioner's proportion of said interest was the sum of \$2,250.25.

(f) The Inheritance Tax Appraiser of the State of California determined that a portion of said transfers made by said decedent prior to her death was subject to state inheritance taxes, and said taxes became due and payable on January 23, 1939. The total amount of said taxes was the sum of \$182,857.20, one-half of said sum having been assessed on account of petitioner's interest in said estate and in said transfers, and in certain insurance moneys received by reason of the death of said decedent. On January 20, 1939, petitioner and her said sister, in equal proportions as between themselves, paid to the State Treasurer of the State of California on account of said state inheritance taxes the sum of \$131,026.00. On September 23, 1940, petitioner and her said sister, in equal proportions as between themselves, paid to said State Treasurer of the State of California the balance of said state inheritance taxes in the amount of \$51,831.20 together with interest thereon in the amount of \$6,046.97. Petitioner's proportion of said interest was the sum of \$3,023.48.

(g) The Commissioner has erroneously disallowed the deduction of said interest in the amount of \$2,250.25 paid to the Collector of Internal Revenue and said interest in the amount of \$3,023.48 paid to said State Treasurer, taken by petitioner on her income tax return as aforesaid.

(h) During the calendar year 1940 petitioner

owned directly 6 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 972 shares of the capital stock of said corporation. During the calendar year 1940 petitioner was a beneficiary of a trust known as the Grace S. Hamilton Trust, Crocker First National Bank of San Francisco, et al., trustees, and as such beneficiary was entitled to receive one-half of the income of said trust during said year. Included in the assets of said trust during said year were voting trust certificates representing 1340 shares of the capital stock of J. D. and A. B. Spreckels Company.

(i) During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$68.00 per share. Petitioner received, either directly or indirectly, from said distributions the sum of \$112,064.00. On her Income Tax Return (Form 1040) for the calendar year 1940 petitioner excluded approximately 82% of said distributions as non-taxable distributions and reported approximately 18% thereof as follows: On line 2 (included in the sum of \$12,261.23) the sum of \$11,922.64 representing dividends received on 978 shares; and on line 7, as income received from said Grace S. Hamilton Trust (included in the sum of \$10,327.56) the amount of \$8,200.80 representing dividends on 670 shares.

(j) The Commissioner has erroneously increased petitioner's dividend income, reported on line 2 of her said return, by the amount of \$54,484.00 and

has erroneously increased petitioner's fiduciary income, reported on line 7 of her return, by the amount of \$37,359.20. The total of said adjustments in the amount of \$91,843.20 represents approximately 82% of the distributions received by petitioner, either directly or indirectly, from J. D. and A. B. Spreckels Company during the calendar year 1940 and which petitioner did not report on the ground that such distributions constituted non-taxable distributions as aforesaid.

(k) Petitioner alleges that only a portion of said cash distributions in the sum of \$112,064.00 received by petitioner, either directly or indirectly, during the calendar year 1940 from said J. D. and A. B. Spreckels Company, to wit: the sum of not more than \$22,645.89 was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1940, and that the balance of said sum of \$112,064.00, to wit: an amount not less than the sum of \$89,418.11, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1940, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(1) Petitioner is informed and believes, and therefore alleges, that on January 1, 1940, J. D. and A. B. Spreckels Company had no earnings or profits accumulated since March 1, 1913, and that its earnings or profits for the calendar year 1940

did not exceed \$274,827.56. During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$1,360,000.

(m) The basis to petitioner on January 1, 1940, for income tax purposes, of each share of the capital stock of J. D. and A. B. Spreckels Company, and of each share of said stock represented by voting trust certificates, held by said petitioner during the calendar year 1940, was greater than the aggregate cash distributions made by said corporation during said year on each of said shares. The basis to said Grace S. Hamilton Trust on January 1, 1940, for income tax purposes, of each share of stock represented by voting trust certificates, held by said trust during the calendar year 1940, was greater than the aggregate cash distributions made by said corporation during said calendar year 1940 on each of said shares.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that the deficiency in income tax for the calendar year 1940 does not exceed \$406.53.

/s/ LEON DE FREMERY,  
Counsel for Petitioner.

State of California,  
City and County of San Francisco—ss.

Grace H. Kelham, being duly sworn, says:

That she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, is familiar with the statements con-

tained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and those she believes to be true.

/s/ GRACE H. KELHAM.

Subscribed and sworn to before me this 7th day of June, 1944.

[Seal] /s/ W. W. HEALLY,  
Notary Public in and for the City and County of  
San Francisco, State of California.

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### EXHIBIT A

Form 1230.

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street  
San Francisco 5, California

Office of  
Internal Revenue Agent in Charge  
San Francisco Division

IRA:90-D-LB  
(C:TS:PD SF:WGW)

May 26, 1944.

Mrs. Grace H. Kelham  
11th Floor Crocker Building  
San Francisco, California

Dear Mrs. Kelham:

You are advised that the determination of your income tax liability for the taxable year ended De-

ember 31, 1940, discloses a deficiency of \$48,658.15 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco 5, California, for the attention of—Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

JOSEPH D. NUNAN, JR.,  
Commissioner.

By F. M. HARLESS,  
Internal Revenue Agent in  
Charge.

HJB

Enclosures:

Statement.

Form of waiver.

## Statement

San Francisco  
IRA:90-D-LB  
(C:TS:PD  
SF:WGW)

Mrs. Grace H. Kelham  
11th Floor Crocker Building  
San Francisco, California

## Tax Liability for the Taxable Year Ended December 31, 1940

	Liability	Assessed	Deficiency
Income Tax .....	\$49,358.78	\$700.63	\$48,658.15

In making this determination of your income tax liability, careful consideration has been given to your protest dated March 10, 1943, and to the statements made at the conferences held on April 30, 1943, February 15, 1944, and February 23, 1944.

A copy of this letter and statement has been mailed to your representative, Mr. Leon de Fremery, 1110 Crocker Building, San Francisco, California, in accordance with the authority contained in the power of attorney, executed by you and on file in this office.

## Adjustments to Net Income

Net income as disclosed by return.....	\$11,966.80
Unallowable deductions and additional income:	
(a) Dividends .....	\$54,484.00
(b) Fiduciary income .....	37,368.25
(c) Rental income .....	277.50
(d) Interest .....	5,273.73
	97,403.48
Net income adjusted .....	\$109,370.28

## Explanation of Adjustments

(a) and (b). Dividends received directly from J. D. and A. B. Spreckels Co. and reported on your return are revised as follows:

Amount received .....	\$66,406.64
Reported on line 2 of your return, 18 per cent or.....	11,922.64

Balance, 82 per cent, held to be taxable.....	\$54,484.00
Dividends from J. D. and A. B. Spreckels Co. received through trust u/d Grace S. Hamilton, total....	\$47,686.76
Reported on line 7 of your return.....	10,327.56

Balance, 82 per cent, held to be taxable.....	\$37,359.20
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Add: Trustee's expense allocable to exempt interest under section 24(a)(5) Internal Revenue Code .....	9.05
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Total increase in fiduciary income.....	\$37,368.25
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You contend that your share of distributions by J. D. and A. B. Spreckels Company, a corporation, in which you owned stock directly and in which trusts of which you were a beneficiary owned stock, is taxable to the extent of only 18 per cent. It is held that the distributions are out of earnings and profits accumulated after February 28, 1913, and are taxable as dividends in their entirety.

(1) Gross rental income, from 2006 Washington Street, a community apartment was received in the amount of \$2,497.50 in place of \$2,220.00 as shown on your return. Taxable net income is therefore increased in the amount of \$277.50.

(d) You claimed on your income tax return for 1940, deductions for interest upon deficiencies in federal estate tax and state inheritance tax in the amounts of \$2,250.25 and \$3,025.48, respectively, said amounts relating to the Estate of Grace S. Hamilton, Deceased. It is held that the above-mentioned amounts aggregating \$5,273.73 were not paid on your indebtedness and are not deductible. See section 23(b) of the Internal Revenue Code.

**Computation of Alternative Tax  
(Section 117 (c)—Internal Revenue Code)**

Net income .....	\$109,370.28
Plus: Net long-term capital loss.....	128.49
Ordinary net income .....	\$109,498.77
Less: Personal exemption .....	\$2,000.00
Credit for dependents .....	800.00
	2,800.00
Balance (surtax net income) .....	\$106,698.77
Less: Earned income credit .....	349.50
Net income subject to normal tax.....	\$106,349.27
Normal tax at 4 per cent on \$106,349.27.....	\$ 4,253.97
Surtax on \$106,698.77.....	40,665.29
Partial tax .....	\$ 44,919.26
Minus: 30 per cent of net long-term loss.....	38.55
Alternative tax .....	\$ 44,880.71

## Computation of Tax

Net income adjusted .....	\$109,370.28
Less: Personal exemption .....	\$2,000.00
Credit for dependents .....	800.00
	2,800.00
Balance (surtax net income) .....	\$106,570.28
Less: Earned income credit .....	349.50
Net income subject to normal tax.....	\$106,220.78
Normal tax at 4 per cent on \$106,220.78.....	\$ 4,248.83
Surtax on \$106,570.28.....	40,590.76
Total tax (Ordinary rates) .....	\$ 44,839.59
Alternative tax .....	\$ 44,880.71
Add: Defense tax—10 per cent.....	4,488.07
Total tax .....	\$ 49,368.78
Less: Income tax paid at the source.....	10.00
Correct income tax liability .....	\$ 49,358.78
Income tax assessed:	
Original, account No. 848617—	
First California District .....	700.63
Deficiency of income tax .....	\$ 48,658.15

Received and filed June 12, 1944, T.C.U.S.

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[Title of Tax Court and Cause.]

Docket No. 5333

**ANSWER**

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits that the taxes in controversy are income taxes for the calendar year 1940; denies all other allegations contained in paragraph 3 of the petition.
4. (a) and (b). Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 and subparagraphs (a) and (b) thereunder of the petition.
5. (a) Admits that the petitioner deducted from gross income on line 14 of her income tax return (Form 1040) for the calendar year 1940 interest in the total sum of \$8,533.24; for lack of information and belief, denies all other allegations contained in subparagraph (a) of paragraph 5 of the petition.  
(b) Admits that the petitioner is one of the daughters of Grace S. Hamilton, who died during 1937, leaving an estate subject to probate. For lack of information and belief, denies all other allegations contained in subparagraph (b) of paragraph 5 of the petition.  
(c) and (d) For lack of information and belief, denies all allegations contained in subparagraphs (c) and (d) of paragraph 5 of the petition.  
(e) Admits that during the calendar year 1940 said Commissioner determined that there was a deficiency in Federal estate tax due from the estate of said decedent; for lack of information and belief,

denies all other allegations contained in subparagraph (e) of paragraph 5 of the petition.

(f) For lack of information and belief, denies all allegations contained in subparagraph (f) of paragraph 5 of the petition.

(g) Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) Admits that during the calendar year 1940 petitioner owned shares of capital stock of J. D. and A. B. Spreckels Company and trust certificates representing shares of the capital stock of said corporation; admits that during the calendar year 1940 petitioner was a beneficiary of the trust known as the Grace S. Hamilton Trust, Crocker First National Bank of San Francisco, et al., Trustees, and as such beneficiary was entitled to receive income of said trust during said year; admits that included in the assets of said trust during said year were trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; for lack of information and belief, denies all other allegations contained in subparagraph (h) of paragraph 5 of the petition.

(i) Admits that during the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that petitioner received certain of said distributions and that on her income tax return (Form 1040) for the calendar year 1940 she excluded portions of said distributions on the theory that such portions were non-taxable; for lack of information and belief, denies all other allegations contained in subparagraph (i) of paragraph 5 of the petition.

(j) Admits that the Commissioner has increased petitioner's dividend income, reported in line 2 of her said return, by the amount of \$54,484.00, and has increased petitioner's fiduciary income, reported on line 7 of her return, by the amount of \$37,359.20, but denies that said increases were erroneously made; for lack of information and belief, denies all other allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Denies the allegations contained in subparagraph (k) of paragraph 5 of the petition.

(l) and (m) For lack of information and belief, denies all allegations contained in subparagraphs (l) and (m) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel,

T. M. MATHER,  
ARTHUR L. MURRAY,  
Special Attorneys,  
Bureau of Internal Revenue.

Received and filed July 24, 1944, T. C. U. S.

The Tax Court of the United States  
Docket No. 5333

GRACE H. KELHAM,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5334

LEILA H. NEILL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5495

ELLIS M. MOORE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5559

HARRIET H. BELCHER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 5560

LILLIE S. WEGEFORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION OF FACTS RE  
DIVIDEND ISSUE

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled cases, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

During the calendar years 1938, 1939 and 1940, petitioners (and others) received dividends from J. D. and A. B. Spreckels Company, the taxability of which is in issue between the parties to this proceeding and will depend upon the final decision rendered with respect to the following issues:

1. Whether the transfer by Oceanic Steamship Company on November 16, 1912, of 23,647 shares of its stock to J. D. Spreckels & Bros. Company in consideration for the cancellation and surrender by J. D. Spreckels & Bros. Company of notes payable by Oceanic Steamship Company to J. D. Spreckels & Bros. Company reduced the operating deficit of said Oceanic Steamship Company.
2. Whether the operating deficits of Oceanic Steamship Company and Kilauea Sugar Plantation Company as of March 1, 1913, must be restored by subsequent earnings or profits in determining the amount of earnings or profits available for dividends.
3. Whether the operating deficits of Seventh and Hill Building Corporation and Monterey County Water Company, wholly-owned subsidiaries of J. D. and A. B. Spreckels Company, were transferred to J. D. and A. B. Spreckels Company at the time of the liquidation of the said wholly-owned subsidiaries.

## I.

Facts relating to issue numbered (1) above

- (1) Oceanic Steamship Company was incorporated under the laws of the State of California on December 24, 1881, with an authorized capital of 25,000 shares of common capital stock of the par value of \$100 per share. Payment of the subscription price of \$100 per share for the original stock

issue of 25,000 shares was made by the corporation calling for the payment in installments over a period of twenty years. These installments of the subscription price were described in the books of account of the corporation as "assessments." By the end of 1902 the original issue of stock was fully paid up, \$2,500,000.00 in cash having been paid in therefor.

(2) On April 29, 1903, an additional 25,000 shares of stock of the par value of \$100 per share was authorized and was thereafter issued on April 30, 1903, to stockholders of record pro rata. Upon the issuance of this stock, the Capital Stock account was credited with \$2,500,000 and an account entitled "Stock Bonus Account" was debited in like amount, and at all times thereafter during the existence of the corporation the Capital Stock account remained at \$5,000,000. At the date of this transaction the corporation had a deficit in excess of \$1,500,000, of which approximately \$750,000 resulted from operations of the business. Thereafter assessments were levied by the corporation on all outstanding capital stock, and as these assessments were levied they were credited to the Stock Bonus account. The following schedule per books reflects: (a) Date of assessment; (b) Applicable to Number of Shares; (c) Amount per Share; (d) Amount Total Assessment; (e) Amount Paid, and (f) Amount Unpaid:

## Applicable Amt.

Date of Assessment	to No. of Shares	per Share	Total Assessment	Amt. Paid	Amount Unpaid
#20— 2/20/06	50,000	\$ 2.00	\$ 100,000.00	\$ 74,094.00	\$ 25,906.00
#21— 3/19/07	37,047	10.00	370,470.00	264,490.00	105,980.00
#22— 5/ 8/07	26,449	10.00	264,490.00	264,480.00	10.00
#23— 6/29/07	26,448	10.00	264,480.00	263,530.00	950.00
#24— 8/20/07	26,353	10.00	263,530.00	263,530.00	-----
#25—10/ 3/07	26,353	10.00	263,530.00	263,530.00	-----
					134,210.26
			\$52.00	\$1,526,500.00	\$1,393,654.00
					\$132,846.00
					1,364.26

[Italicised figures appear in pencil on original.]

(3) The shares of stock on which the assessments listed in the preceding schedule had not been paid were bid in by the corporation pursuant to delinquency sale and thereafter carried on its books as treasury stock in the amount of \$134,210.26. Said \$134,210.26 represented the total of the unpaid assessments for which these shares were bid in together with charges in connection therewith. The capital stock record maintained by Oceanic Steamship Company reflects the following:

Date of Issuance	Cert. No.	Issued in Name of	No. of Shares
9/21/1906.....	#1261	Oceanic Steamship Co.	12,953
5/ 6/1907.....	#1260	Oceanic Steamship Co.	10,598
6/28/1907.....	#1262	Oceanic Steamship Co.	1
8/19/1907.....	#1263	Oceanic Steamship Co.	95

(4) On November 16, 1912, Oceanic Steamship Company transferred said 23,647 shares of its stock to J. D. Spreckels & Bros. Company in consideration of the cancellation and surrender to Oceanic Steamship Company by J. D. Spreckels & Bros. Company of notes of Oceanic Steamship Company

in the principal sum of \$1,204,070.48 together with accrued interest thereon in the amount of \$79,623.91. Said transfer was made pursuant to resolutions of the Boards of Directors of Oceanic Steamship Company and J. D. Spreckels & Bros. Company, true copies of which are attached hereto and marked Exhibits 1-A and 2-B, respectively, hereof. The certificates referred to in paragraph three hereof were cancelled on November 16, 1912, and on that date Certificate #1275 for 23,647 shares of capital stock of Oceanic Steamship Company was issued by the latter to J. D. Spreckels & Bros. Company.

(5) Oceanic Steamship Company made the following entries on its books of account: On November 16, 1912, it charged "Bills Payable" with the principal sum of said notes in the amount of \$1,204,070.48 and charged "Interest Accrued on Notes" with the accrued interest thereon in the amount of \$79,623.91, the total of these two items in the amount of \$1,283,694.39 being credited to an account entitled "Deficiency"; and the Treasury Stock account was credited with the balance remaining in said account in the amount of \$134,210.26 and this amount was charged to said "Deficiency" account. On December 31, 1912, the balance of \$973,500.00 remaining in the Stock Bonus account was written off and this amount was charged to said "Deficiency" account.

(6) On October 31, 1912, Oceanic Steamship Company had total assets per books, exclusive of said treasury stock, in the amount of \$3,746,134.32 and total liabilities (other than capital) of \$3,942,-

122.59. Except for depreciation in the amount of \$101,127.86 taken in prior years on one vessel, no depreciation had ever been entered in its books by the company on the three steamers then owned by it, and at a special meeting of the Board of Directors held on November 16, 1912, the Secretary of the company was instructed to write down the value of its steamers as of December 31, 1912, in the total amount of \$1,553,386.45, which was the amount required to make the book values of the three steamers correspond to their total appraised valuation of \$2,041,222.00. This write-off was charged to depreciation and it is agreed that said charge was proper. Applying this adjustment to the aforesaid book values of the assets of Oceanic Steamship Company as of October 31, 1912, gives a corrected book value of \$2,192,747.87 or \$1,749,374.72 less than the liabilities. Attached hereto and marked "Exhibit 3-C" are balance sheets per books of Oceanic Steamship Company as of October 31, 1912, and December 31, 1912.

(7) In 1899 and 1900 Oceanic Steamship Company issued \$2,500,000 first mortgage 5% bonds, of which \$2,405,000 were outstanding in 1906 and \$1,803,000 were outstanding in 1912. Beginning with the semi-annual interest payment due July 1, 1906, the company began to default on the payment of interest on these bonds, the payments made being about six months in arrears, funds being borrowed from J. D. Spreckels & Bros. Company to pay delinquent interest from time to time. Beginning with the coupon due July 1, 1909, no interest was

paid until December, 1915, when the interest due for the period January 1, 1909, to July 1, 1911, inclusive, was paid. All of the outstanding bonds were redeemed in 1917 and interest thereon paid in full.

(8) The investment of J. D. Spreckels & Bros. Company in the capital stock of Oceanic Steamship Company was reflected on its books as follows:

	Shares	Investment Per Books
Purchased 1881-1907 .....	18,303	\$ 807,135.23
Assessments paid 1906-1907 .....		903,778.00
Received in 1912 in payment of notes and accrued interest .....	23,647	1,113,732.50
 Total.....	41,950	\$2,824,645.73

The difference between said face value of said notes in the amount of \$1,204,070.48 as hereinabove stated (Paragraph 4) and the amount of \$1,113,732.50 set forth in the above schedule is due to accrued interest included in the face value of said notes but not accrued on the books of J. D. Spreckels & Bros. Company. Similarly, the accrued interest on said notes in the amount of \$79,623.91 referred to in Paragraph 4 hereof had not been accrued on the books of J. D. Spreckels & Bros. Company. On December 10, 1913, the directors of J. D. Spreckels & Bros. Company authorized the writedown of the investment of that company in the stock of Oceanic Steamship Company totalling 41,950 shares, from a cost of \$2,824,645.73 to \$100.00. The parties to this proceeding, in agreeing upon the settlement of other issues involved in the taxability of dividends declared by J. D. and A. B. Spreckels Company,

have agreed that the capital stock of Oceanic Steamship Company was worthless as of September 26, 1912, the date of the transfer of the stock of J. D. Spreckels & Bros. Company to J. D. and A. B. Spreckels Securities Company, the predecessor of J. D. and A. B. Spreckels Company. The acquisition and disposition of said 23,647 shares of capital stock were the only transactions Oceanic Steamship Company ever had in its capital stock other than the original issuance thereof.

(9) From July 28, 1907, to September 26, 1912, J. D. Spreckels and A. B. Spreckels, either directly or through ownership of J. D. Spreckels & Bros. Company, owned in excess of 96% of the outstanding capital stock of Oceanic Steamship Company, exclusive of said treasury stock. From its incorporation in 1892 to September 26, 1912, the capital stock of J. D. Spreckels & Bros. Company was entirely owned, with the exception of directors' qualifying shares, by J. D. Spreckels and A. B. Spreckels in equal amounts. On September 26, 1912, said capital stock was transferred by said brothers together with other property to J. D. and A. B. Spreckels Securities Company in exchange for all its capital stock, and thereafter and until 1922 said brothers owned in equal amounts all of said outstanding capital stock. J. D. and A. B. Spreckels Securities Company continued to own all the outstanding capital stock of J. D. Spreckels & Bros. Company after the acquisition of said stock on September 26, 1912, as aforesaid until the dissolution of the last named company on July 12, 1928.

(10) On September 26, 1912, and until the transfer of said 23,647 shares of the capital stock of Oceanic Steamship Company to J. D. Spreckels & Bros. Company as aforesaid on November 16, 1912, the outstanding capital stock of Oceanic Steamship Company, exclusive of said treasury stock, was owned as follows:

18,303 shares or 69.45% by J. D. Spreckels & Bros. Company and 8,050 shares or 30.55% by J. D. and A. B. Spreckels Securities Company.

(11) The indebtedness of Oceanic Steamship Company to J. D. Spreckels & Bros. Company above referred to in the principal amount of \$1,204,070.48 represented moneys advanced for financing the activities of Oceanic Steamship Company, together with accrued interest in undisclosed amounts.

(12) On the basis of the foregoing facts, respondent contends that Oceanic Steamship Company realized a gain of \$1,149,484.13 or otherwise reduced its operating deficit by that amount upon the transfer of 23,647 shares of its capital stock to J. D. Spreckels & Bros. Company in 1912 computed as follows:

Principal amount of notes cancelled . . .	\$1,204,070.48
Accrued interest thereon . . . . .	79,623.91

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\$1,283,694.39

Less bid in price on delinquent stock sales . . . . .	134,210.26
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\$1,149,484.13

On the other hand, petitioners contend that said transaction was a capital transaction which did not result in any realization of gain or otherwise reduce the operating deficit of Oceanic Steamship Company.

## II.

Facts relating to issue numbered (2) above

(13) As of March 1, 1913, Oceanic Steamship Company and Kilauea Sugar Plantation Company had operating deficits in the following amounts:

Oceanic Steamship Company

In the event issue numbered (1)  
above is decided in favor of  
petitioners .....\$4,878,987.40

In the event issue numbered (1)  
above is decided in favor of  
respondent .....\$3,729,503.27

Kilauea Sugar Plantation Company...\$ 308,429.18

(14) Subsequent to March 1, 1913, Oceanic Steamship Company and Kilauea Sugar Plantation Company realized earnings or profits and declared certain dividends as hereinafter set forth. The question presented for the decision of the court is whether the earnings or profits of said companies realized subsequent to March 1, 1913, must first be applied to eliminate said operating deficits as of March 1, 1913, before said corporations can have accumulated earnings or profits available for dividends.

(15) On November 18, 1936, Oceanic Steamship

Company transferred all its assets to J. D. and A. B. Spreckels Company in complete liquidation within the meaning of Section 112 (b)(6) of the Revenue Act of 1936. On said date and since the year 1917 Oceanic Steamship Company was a wholly-owned subsidiary of J. D. and A. B. Spreckels Company, or its predecessor J. D. and A. B. Spreckels Securities Company.

(16) The following schedule shows the operating deficit of Oceanic Steamship Company as of March 1, 1913; the earnings or profits of said company realized subsequent thereto; the dividends paid; and the accumulated earnings or profits transferred to J. D. and A. B. Speckels Company upon the liquidation of Oceanic Steamship Company. All of said figures are shown in four columns, in order to show the results depending upon whether the operating deficit as of March 1, 1913, does or does not have to be made up from subsequent earnings or profits and also to show the result in the event that issue (1) above is decided in favor of petitioner or is decided in favor of respondent:

March 1, 1913 Operating Deficit Made Up From Subsequent Earnings or Profits	March 1, 1913 Operating Deficit Not Made Up From Subsequent Earnings or Profits		
	Issue No. 1 Decided in Favor of Petitioner	Issue No. 1 Decided in Favor of Petitioner	Issue No. 1 Decided in Favor of Petitioner
Oceanic Steamship Company			
Operating deficit, March 1, 1913.....	\$4,878,987.40	\$3,729,503.27	\$4,878,987.40
Earnings or profits realized during the period from March 1, 1913, to March 15, 1922.....	6,830,763.76	6,830,763.76	6,830,763.76
Available for dividends.....	1,951,776.36	3,101,260.49	6,830,763.76
Dividend paid, March 15, 1922.....	500,000.00	500,000.00	500,000.00
Balance, March 15, 1922.....	1,451,776.36	2,601,260.49	6,330,763.76
Earnings or profits, March 16 to June 30, 1922.....	82,850.29	82,850.29	82,850.29
Available for dividends.....	1,534,626.65	2,684,110.78	6,413,614.05
Dividend paid, June 30, 1922.....	200,000.00	200,000.00	200,000.00
Balance, June 30, 1922.....	1,334,626.65	2,484,110.78	6,213,614.05
Earnings or profits, July 1, 1922, to December 22, 1924.....	448,859.89	448,859.89	448,859.89

Available for dividends.....	1,783,486.54	2,932,970.67	6,662,473.94
Dividend paid, December 22, 1924.....	650,000.00	650,000.00	650,000.00
Balance, December 22, 1924.....	1,133,486.54	2,282,970.67	6,012,473.94
Earnings or profits, December 23, 1924, to May 22, 1926..	201,191.03	201,191.03	201,191.03
Available for dividends.....	1,334,677.57	2,484,161.70	6,213,664.97
Dividend paid, May 22, 1926.....	1,558,319.04	1,558,319.04	1,558,319.04
Proportion of May 22, 1926, dividend which was from capital.....	223,641.47	None	None
Accumulated earnings or profits, May 22, 1926.....	None	925,842.66	4,655,345.93
Earnings or profits, May 23, 1926, to November 18, 1936..	511,627.09	511,627.09	511,627.09
Accumulated earnings or profits, November 18, 1936, transferred to J. D. and A. B. Spreckels			
Company upon liquidation.....\$	511,627.09	\$1,437,469.75	\$5,166,973.02

(17) Prior to March 1, 1913, J. D. and A. B. Spreckels Company and its predecessor in interest owned, and at all times since said date have owned, substantial amounts of the capital stock of Kilauea Sugar Plantation Company and have received dividends therefrom. The following schedule shows the operating deficit of Kilauea Sugar Plantation Company as of March 1, 1913; the earnings or profits of said company realized subsequent thereto; and the dividends declared and paid subsequent to December 31, 1915, which are the only dividends herein material. All of said figures are shown in two columns, the first column showing the result if petitioners are correct in their contention that said operating deficit as of March 1, 1913, must be made up from subsequent earnings or profits before earnings or profits are available for dividends, and the second column showing the result if the respondent is correct in his contention that said operating deficit need not be made up from subsequent earnings or profits:

March 1, 1913 Operating Deficit Made Up From Subsequent Earnings or Profits	March 1, 1913 Operating Deficit Not Made Up From Subsequent Earnings or Profits	
	Earned Surplus or (Deficit)	Dividends From Capital
Operating (deficit), March 1, 1913.....	\$ (308,429.18)	
Undistributed earnings or profits, March 1, 1913, to December 31, 1916.....	127,381.81	127,381.81
Available for dividends (operating deficit).....	(181,047.37)	127,381.81
Dividends paid, 1916—\$120,000 .....	.....	120,000.00
Balance, December 31, 1916 (operating deficit).....	(181,047.37)	7,381.81
Earnings or profits, January 1 to January 2, 1917 .....	449.76	449.76
Available for dividends (operating deficit).....	(180,597.61)	7,831.57
Dividend paid, January 2, 1917—\$10,000 .....	.....	10,000.00
Balance, January 2, 1917 (operating deficit) .....	(180,597.61)	10,000.00
Earnings or profits, January 3 to December 31, 1917 .....	81,632.08	\$ 2,168.43
Available for dividends (operating deficit).....	(98,965.53)	None
Dividend paid, December 31, 1917—\$40,000 .....	.....	81,632.08
Balance, December 31, 1917 (operating deficit) .....	(98,965.53)	40,000.00
		41,632.08

Earnings and profits, January 1 to October 1, 1918.....	21,124.09		21,124.09
Available for dividends (operating deficit).....	(77,841.44)		
Dividend paid, October 1, 1918—\$100,000.....	.....	100,000.00	62,756.17
Balance, October 1, 1918 (operating deficit).....	(77,841.44)		100,000.00
Earnings or profits, Oct. 2, 1918, to Dec. 31, 1921.....	388,943.37		388,943.37
Available for dividends .....			388,943.37
Dividends paid, 1921—\$90,000.....	90,000.00		90,000.00
Balance, December 31, 1921.....	221,101.93		298,943.37
(Operating deficits), Jan. 1, 1922 to June 24, 1931.....	(376,553.68)		(376,553.68)
	(155,451.75)		(77,610.31)
Dividend paid, June 24, 1931—\$100,000.....	.....	100,000.00	100,000.00
Balance, June 24, 1931 (operating deficit).....	(155,451.75)		(77,610.31)
Earnings or profits, June 25, 1931, to Dec. 31, 1935.....	190,439.49		190,439.49
Balance, December 31, 1935.....	34,987.74		112,829.18
Earnings or profits, year 1936.....	38,671.17		38,671.17
Dividend paid, 1936 .....	40,000.00		40,000.00
Balance, December 31, 1936.....	\$ 33,658.91		\$111,500.35
Dividends from capital.....			
			\$370,000.00
			=====
			\$139,412.26
			=====

Note: No dividends were paid during the years 1937 to 1940, inclusive.

(18) The dividends received by J. D. and A. B. Spreckels Company and its predecessor in interest from Kilauea Sugar Plantation Company and the portion thereof which was paid out of earnings or profits in accordance with the foregoing schedule are as follows:

Dividends Paid by Kilauea	Dividends Received by J. D. and A. B. Spreckels	From Earnings or Profits March 1, 1913, Operating Deficit Made Up From Subsequent Earnings or Profits	From Earnings or Profits March 1, 1913, Operating Deficit Not Made Up From Subsequent Earnings or Profits
1916.....	\$120,000	\$ 65,934.00	\$ 65,934.00
1917.....	50,000	27,472.50	26,281.06
1918.....	100,000	54,945.00	34,481.38
1921.....	90,000	49,450.50	49,450.50
1931.....	100,000	54,945.00	.....
1936.....	40,000	21,978.00	21,978.00
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
	\$500,000	\$274,725.00	\$198,124.94
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

### III.

Facts relating to issue numbered (3) above

(19) Seventh and Hill Building Corporation was a wholly-owned subsidiary of J. D. and A. B. Spreckels Company and on December 13, 1938, said Seventh and Hill Building Corporation transferred all its assets to J. D. and A. B. Spreckels Company in complete liquidation within the meaning of Section 112 (b)(6) of the Revenue Act of 1938. On that date said corporation had an operating deficit accumulated since March 1, 1913, in the amount of \$98,594.01.

(20) Monterey County Water Company was a wholly-owned subsidiary of J. D. and A. B. Spreckels Company and on November 18, 1936, said Monterey County Water Company transferred all its assets to J. D. and A. B. Spreckels Company, in complete liquidation within the meaning of Section 112 (b) (6) of the Revenue Act of 1936. On that date said corporation had an operating deficit accumulated since March 1, 1913, in the amount of \$47,030.64.

(21) The question for decision by the court is whether said operating deficits of said wholly-owned subsidiaries were transferred to the parent company, J. D. and A. B. Spreckels Company, upon the liquidation of said subsidiaries.

(22) The parties hereto have agreed that, depending upon the decision of the court with respect to the foregoing issues, the earnings or profits of J. D. and A. B. Spreckels Company available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

1. In the event all the foregoing issues are decided in favor of petitioner, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$1,990,621.89		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	(98,594.01)		
Available for dividends .....	728,393.83		
Dividends paid, January 1 to December 15, 1938—\$600,000.....	600,000.00	\$ 600,000.00	None
Balance, December 15, 1938.....	128,393.83		
(Operating deficit) December 15, 1938, to December 21, 1938.....	(23,406.43)		
Available for dividends .....	104,987.40		
Dividend paid, December 22, 1938—\$250,000.....	104,987.40	104,987.40	\$ 145,012.60
Balance, December 22, 1938.....	None		
(Operating deficit) December 22, 1938, to December 31, 1938.....	(33,437.76)		
Balance, December 31, 1938 (operating deficit) .....	(33,437.76)		
Earnings or profits, year 1939, available for dividends.....	604,432.80		
Dividends paid, year 1939—\$1,100,000.....	604,432.80	604,432.80	495,567.20

Balance, December 31, 1939 (operating deficit).....	(33,437.76)
Earnings or profits, year 1940, available for dividends.....	304,193.21
Dividends paid, year 1940—\$1,360,000.....	304,193.21
	<hr/>
Balance, December 31, 1940 (operating deficit).....	(33,437.76)
	<hr/>
Total dividends for the years 1938 to 1940, inclusive.....	\$1,613,613.41
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2. In the event the first and second of the foregoing issues are decided in favor of petitioner and the third issue is decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$2,037,652.53		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	None		
Available for dividends .....	874,018.48		
Dividends paid, January 1 to December 15, 1938—\$600,000 .....	600,000.00	\$ 600,000.00	None
Balance, December 15, 1938.....	274,018.48		
(Operating deficit) December 15, 1938, to December 21, 1938 .....	(23,406.43)		
Available for dividends .....	250,612.05		
Dividend paid, December 22, 1938—\$250,000 .....	250,000.00	250,000.00	None
Balance, December 22, 1938.....	612.05		
(Operating deficit) December 22, 1938, to December 31, 1938 .....	(33,437.76)		
Balance, December 31, 1938 (operating deficit) .....	(32,825.71)		
Earnings or profits, year 1939, available for dividends.....	604,432.80		

Dividends paid, year 1939—\$1,100,000.....	604,432.80	604,432.80	\$ 495,567.20
Balance, December 31, 1939 (operating deficit) .....	(32,825.71)		
Earnings or profits, year 1940, available for dividends.....	304,193.21		
Dividends paid, year 1940—\$1,360,000.....	304,193.21	304,193.21	1,055,806.79
Balance, December 31, 1940 (operating deficit) .....	(32,825.71)		
Total dividends for the years 1938 to 1940, inclusive.....	<u><u>\$3,310,000.00</u></u>	<u><u>\$1,758,626.01</u></u>	<u><u>\$1,551,373.99</u></u>

3. In the event the first and third of the foregoing issues are decided in favor of petitioner and the second issue is decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938		\$6,728,579.54	
(Operating deficit) January 1, 1938, to December 14, 1938.....		(1,163,634.05)	
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....		(98,594.01)	
Available for dividends .....		5,466,351.48	
Dividends paid, January 1 to December 15, 1938—\$600,000.....		600,000.00	
Balance, December 15, 1938.....		4,866,351.48	
(Operating deficit) December 15, 1938, to December 21, 1938.....		(23,406.43)	
Available for dividends .....		4,842,945.05	
Dividend paid, December 22, 1938—\$250,000.....		250,000.00	
Balance, December 22, 1938.....		4,592,945.05	
(Operating deficit) December 22, 1938, to December 31, 1938.....		(33,437.76)	
Balance, December 31, 1938 .....		4,559,507.29	

Earnings or profits, year 1939 .....	604,432.80
Available for dividends .....	<u>5,163,940.09</u>
Dividends paid, year 1939—\$1,100,000.....	1,100,000.00
Balance, December 31, 1939 .....	<u>4,063,940.09</u>
Earnings or profits, year 1940 .....	304,193.21
Available for dividends .....	<u>4,368,133.30</u>
Dividends paid, year 1940—\$1,360,000.....	1,360,000.00
Balance, December 31, 1940 .....	<u>3,008,133.30</u>
Total dividends for the years 1938 to 1940, inclusive.....	<u>\$3,310,000.00</u>

4. In the event of the second and third of the foregoing issues are decided in favor of petitioner and the first issue is decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$2,969,313.32		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	(98,594.01)		
		<hr/>	
Available for dividends .....	1,707,085.26		
Dividends paid, January 1 to December 15, 1938—\$600,000.....	600,000.00		
		<hr/>	
Balance, December 15, 1938.....	1,107,085.26		
(Operating deficit) December 15, 1938, to December 21, 1938.....	(23,406.43)		
		<hr/>	
Available for dividends .....	1,083,678.83		
Dividend paid, December 22, 1938—\$250,000.....	250,000.00		
		<hr/>	
Balance, December 22, 1938.....	833,678.83		
(Operating deficit) December 22, 1938, to December 31, 1938.....	(33,437.76)		
		<hr/>	
Balance, December 31, 1938.....	800,241.07		

Earnings or profits, year 1939 .....	604,432.80	
Available for dividends .....	<u>1,404,673.87</u>	None
Dividends paid, year 1939—\$1,100,000 .....	<u>1,100,000.00</u>	
Balance, December 31, 1939 .....	<u>304,673.87</u>	
Earnings or profits, year 1940 .....	<u>304,193.21</u>	
Available for dividends .....	<u>608,867.08</u>	
Dividends paid, year 1940—\$1,360,000 .....	<u>608,867.08</u>	
Balance, December 31, 1940 .....	<u>None</u>	
Total dividends for the years 1938 to 1940, inclusive .....	<u>\$2,558,867.08</u>	<u>\$ 751,132.92</u>

i. In the event the first of the foregoing issues is decided in favor of petitioner and the second and third issues are decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$6,775,610.18		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	None		
Available for dividends .....		<u>5,611,976.13</u>	
Dividends paid, January 1 to December 15, 1938—\$600,000.....		600,000.00	
Balance, December 15, 1938.....		<u>5,011,976.13</u>	
(Operating deficit) December 15, 1938, to December 21, 1938.....		(23,406.43)	
Available for dividends .....		<u>4,988,569.70</u>	
Dividend paid, December 22, 1938—\$250,000.....		250,000.00	
Balance, December 22, 1938.....		<u>4,738,569.70</u>	
(Operating deficit) December 22, 1938, to December 31, 1938.....		(33,437.76)	
Balance, December 31, 1938.....		<u>4,705,131.94</u>	

Earnings or profits, year 1939.....	604,432.80	
Available for dividends .....	5,309,564.74	
Dividends paid, year 1939—\$1,100,000.....	1,100,000.00	None
Balance, December 31, 1939.....	4,209,564.74	
Earnings or profits, year 1940.....	304,193.21	
Available for dividends .....	4,513,757.95	
Dividends paid, year 1940—\$1,360,000.....	1,360,000.00	1,360,000.00
Balance, December 31, 1940.....	3,153,757.95	
Total dividends for the years 1938 to 1940, inclusive.....	\$3,310,000.00	None

6. In the event the third of the foregoing issues is decided in favor of petitioner and the first and second issues are decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$6,728,579.54		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	(98,594.01)		
Available for dividends .....	5,466,351.48		
Dividends paid, January 1 to December 15, 1938—\$600,000.....	600,000.00	\$ 600,000.00	None
Balance, December 15, 1938.....	4,866,351.48		
(Operating deficit) December 15, 1938, to December 21, 1938.....	(23,406.43)		
Available for dividends .....	4,842,945.05		
Dividend paid, December 22, 1938—\$250,000.....	250,000.00	250,000.00	None
Balance, December 22, 1938.....	4,592,945.05		
(Operating deficit) December 22, 1938, to December 31, 1938.....	(33,437.76)		
Balance, December 31, 1938.....	4,559,507.29		

Earnings or profits, year 1939 .....	604,432.80	
Available for dividends .....	<u>5,163,940.09</u>	None
Dividends paid, year 1939—\$1,100,000 .....	<u>1,100,000.00</u>	
Balance, December 31, 1939 .....	<u>4,063,940.09</u>	
Earnings or profits, year 1940 .....	<u>304,193.21</u>	
Available for dividends .....	<u>4,368,133.30</u>	None
Dividends paid, year 1940—\$1,360,000 .....	<u>1,360,000.00</u>	
Balance, December 31, 1940 .....	<u>3,008,133.30</u>	
Total dividends for the years 1938 to 1940, inclusive .....	<u><u>\$3,310,000.00</u></u>	None

7. In the event the second of the foregoing issues is decided in favor of petitioner and the first and third issues are decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$3,016,343.96		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	None		
Available for dividends .....		1,852,709.91	
Dividends paid, January 1 to December 15, 1938—\$600,000.....	600,000.00		
Balance, December 15, 1938.....		1,252,709.91	
(Operating deficit) December 15, 1938, to December 21, 1938.....	(23,406.43)		
Available for dividends .....		1,229,303.48	
Dividend paid, December 22, 1938—\$250,000.....	250,000.00		
Balance, December 22, 1938.....		979,303.48	
(Operating deficit) December 22, 1938, to December 31, 1938.....	(33,437.76)		
Balance, December 31, 1938.....		945,865.72	

Earnings or profits, year 1939.....	604,432.80		
Available for dividends .....	1,550,298.52		
Dividends paid, year 1939—\$1,100,000.....	1,100,000.00		
Balance, December 31, 1939.....	450,298.52		
Earnings or profits, year 1940.....	304,193.21		
Available for dividends .....	754,491.73		
Dividends paid, year 1940—\$1,360,000.....	754,491.73		
Balance, December 31, 1940.....	None		
Total dividends for the years 1938 to 1940, inclusive.....	\$2,704,491.73		
	\$3,310,000.00		

8. In the event all the foregoing issues are decided in favor of respondent, the earnings or profits available for dividends in each of the years 1938, 1939 and 1940, the dividends paid in each of said years, and the portion thereof paid out of earnings or profits are as follows:

	Earnings or Profits	Dividends From Earnings or Profits	Dividends From Capital
Accumulated earnings or profits, January 1, 1938.....	\$6,775,610.18		
(Operating deficit) January 1, 1938, to December 14, 1938.....	(1,163,634.05)		
(Operating deficit) of Seventh and Hill Building Corporation at date of liquidation, December 13, 1938.....	None		
Available for dividends .....	5,611,976.13		
Dividends paid, January 1 to December 15, 1938—\$600,000.....	600,000.00	\$ 600,000.00	None
Balance, December 15, 1938.....	5,011,976.13		
(Operating deficit) December 15, 1938, to December 21, 1938.....	(23,406.43)		
Available for dividends .....	4,988,569.70		
Dividend paid, December 22, 1938—\$250,000.....	250,000.00	250,000.00	None
Balance, December 22, 1938.....	4,738,569.70		
(Operating deficit) December 22, 1938, to December 31, 1938.....	(33,437.76)		
Balance, December 31, 1938.....	4,705,131.94		

Earnings or profits, year 1939.....	604,432.80	
Available for dividends .....	5,309,564.74	None
Dividends paid, year 1939—\$1,100,000.....	1,100,000.00	1,100,000.00
Balance, December 31, 1939 .....	4,209,564.74	
Earnings or profits, year 1940.....	304,193.21	
Available for dividends .....	4,513,757.95	None
Dividends paid, year 1940—\$1,360,000.....	1,360,000.00	1,360,000.00
Balance, December 31, 1940 .....	3,153,757.95	
Total dividends for the years 1938 to 1940, inclusive.....	\$3,310,000.00	\$3,310,000.00

(23) The maximum portion of the dividends declared by J. D. and A. B. Spreckels Company during the years 1938, 1939 and 1940 which was paid out of capital, as shown by the foregoing eight schedules, is \$1,696,386.59, the amount shown by Schedule 1. During each of the years 1938, 1939 and 1940 J. D. and A. B. Spreckels Company had 20,000 shares of capital stock outstanding. The maximum possible capital distribution per share during said three years is therefore approximately \$84.82 and it is agreed between the parties hereto that the basis of each and every share of stock to each of the petitioners herein is in excess of said amount.

Dated this 29th day of October, 1947.

/s/ LEON de FREMERY,  
Attorney for Petitioners.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

## EXHIBIT 1-A

Excerpt From Minutes of Meeting of Board of  
Directors of J. D. Spreckels and Bros. Co.  
Held on November 15, 1912

On motion of Director A. B. Spreckels, seconded by Director F. S. Samuels, the following Preambles and Resolution were unanimously adopted.

Whereas: This Company holds the following promissory notes of the Oceanic Steamship Company, to wit:

June 4, 1910, promissory note for.....\$ 784,972.23
Dec. 20, 1910, promissory note for..... 344,583.33
Dec. 26, 1911, promissory note for..... 74,514.92

Making a Total of.....\$1,204.070.48

Whereas: Said notes are long past due and neither principal nor interest thereof has been paid, but this Company has, from time to time, charged to the over-draft account of said Oceanic Steamship Company the accrued interest thereon and has been required to take the promissory note of said Oceanic Steamship Company in discharge thereof; and

Whereas: There exists in the treasury of said Oceanic Steamship Company twenty-three thousand six hundred and forty-seven (23,647) shares of its capital stock which the officers of said Company signify their willingness to transfer to this Company, in consideration of the cancellation and return of said Notes.

Now, Therefore Be It Resolved, that the Secretary of this Company be, and he is hereby author-

ized and directed to offer to cancel and return said notes, together with accrued interest thereon, of said Oceanic Steamship Company to said Oceanic Steamship Company, in consideration of the issuance and delivery to this Company of said twenty-three thousand, six hundred and forty-seven (23,647) shares of the capital stock of said Oceanic Steamship Company, and upon receipt of certificates representing said capital stock, so to be issued and delivered as aforesaid, the Secretary of this Company is authorized and directed to so cancel said notes, together with accrued interest thereon, and return the same to the said Oceanic Steamship Company.

#### EXHIBIT 2-B

Excerpt From Minutes of Meeting of Board of Directors of Oceanic Steamship Company Held on November 16, 1912

Director W. D. K. Gibson, Secretary of J. D. Spreckels and Bros. Company, a corporation, read to the meeting a communication in words and figures following, to wit:

“San Francisco, Cal., November 16, 1912  
Oceanic Steamship Company,  
100 Davis Street,  
San Francisco, Cal.

Gentlemen:

I am authorized, by resolution of the Board of Directors of J. D. Spreckels & Bros. Company, to offer to purchase from your Company, 23,647 shares

of its Capital Stock, in consideration of the acceptance by your Company, as payment therefor, of the amounts now due from your Company to J. D. Spreckels & Bros. Company, together with interest thereon, as evidenced by those certain promissory notes heretofore issued by your Company in favor of J. D. Spreckels & Bros. Company, as follows:

June 4, 1910, promissory note for.....	\$ 784,972.23
Dec. 20, 1910, promissory note for.....	344,583.33
Dec. 26, 1911, promissory note for.....	74,514.92

Making a total principal sum of...\$1,204,070.48

Which Promissory Notes and accrued interest I am authorized to cancel and return to you upon receipt of appropriate certificates issued in the name of J. D. Spreckels and Bros. Company for said 23,647 shares of the Capital Stock of your Company.

Yours truly,

J. D. SPRECKELS & BROS.  
COMPANY,

[Seal] By /s/ W. D. K. GIBSON,  
Secretary.

After a discussion of the above communication on motion of Director A. B. Spreckels, seconded by Director Bourdette, which motion was duly put, seconded and carried, the following Resolution was unanimously adopted:

“Resolved: That the offer of J. D. Spreckels & Bros. Company, a corporation, to cancel the bills payable of this Company, of the following amounts and dates, to wit:

June 4, 1910, promissory note for.....	\$ 784,972.23
Dec. 20, 1910, promissory note for.....	344,583.33
Dec. 26, 1911, promissory note for.....	74,514.92

Making a total principal sum of...\$1,204,070.48

together with accrued interest thereon, in consideration of the sale and transfer by this Company to said J. D. Spreckels and Bros. Company, a corporation, of 23,647 shares of the Capital Stock of this Company, which now is in the Treasury of this Company, be, and the same is hereby accepted, and the President and Secretary of this Company are hereby authorized and directed to issue and deliver such stock to said J. D. Spreckels & Bros. Company, a corporation, upon receipt of said above bills payable properly cancelled, together with the cancellation of accrued interest on said above bills payable."

## EXHIBIT 3-C

Oceanie Steamship Company  
(a California corporation)Balance Sheets Per Books  
As of October 31, 1912, and December 31, 1912

	Oct. 31, 1912	Dec. 31, 1912
Assets:		
Cash .....	\$ 328.43	\$ 343.78
Accounts receivable .....	39,207.32	41,810.78
Store and supplies .....	5,131.76	5,001.75
Vessels, equipment, furniture and fixtures .....	3,696,092.77	2,110,029.81
Deferred charges .....	5,374.04	16,670.08
Total assets .....	<u>\$3,746,134.32</u>	<u>\$2,173,856.20</u>
Liabilities:		
Account payable, J. D. Spreckels & Bros. Company .....	\$ 584,978.20	\$ 495,769.11
Accrued interest on bonds .....	270,450.00	360,600.00
Notes payable, J. D. Spreckels & Bros. Company .....	1,204,070.48	.....
Accrued interest on notes payable..	79,623.91	.....
Other .....	.....	5,325.49
	2,139,122.59	861,694.60
First mortgage bonds .....	<u>1,803,000.00</u>	<u>1,803,000.00</u>
Total liabilities .....	<u>\$3,942,122.59</u>	<u>\$2,664,694.60</u>
Capital:		
Capital stock outstanding, 50,000 shares, par \$100 .....	\$5,000,000.00	\$5,000,000.00
(Deduct):		
Treasury stock account .....	(134,210.26)	.....
Stock bonus account .....	(973,500.00)	.....
Deficit .....	(4,088,278.01)	(5,490,838.40)
Total capital (deficiency) .....	(195,988.27)	(490,838.40)
Total liabilities & capital.....	<u>\$3,746,134.32</u>	<u>\$2,173,856.20</u>

Filed at hearing Nov. 3, 1947, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5333

### SUPPLEMENTARY STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled case, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. It is agreed that during the calendar year 1940 petitioner paid the sum of \$5,273.73 as interest and that said sum is allowable in full as a deduction in computing petitioner's taxable income for said year.

2. Petitioner at all times during the calendar year 1940 was the owner of 6 shares of stock of J. D. and A. B. Spreckels Company issued to and standing in her name, and voting trust certificates representing 972 shares of the capital stock of said company. Petitioner received from said company distributions on said shares in the following amount:

Schedule A			
	From Shares Standing	From Shares Covered by Said Voting Trust	
Year	in Her Own Name	Certificates	Total
1940.....	\$408.00	\$66,096.00	\$66,504.00

At all times during the calendar year 1940 petitioner was a beneficiary of a trust known as the Grace S. Hamilton Trust, Crocker First National

Bank of San Francisco, et al., Trustees, and as such beneficiary was entitled to receive one-half of the income of said trust for said year. Included in the assets of said trust for said year were voting trust certificates representing 1,340 shares of the capital stock of J. D. and A. B. Spreckels Company. The distributions received by the trustees from said company were, under the terms of the trust, after deducting certain prior charges and expenses of the trust, currently distributable to the beneficiary. During said year 1940 the trustees made distributions as required by the terms of the trust and petitioner received from the trustees as petitioner's net share of the said distributions of J. D. and A. B. Spreckels Company on said 1,340 shares the following amount:

## Schedule B

Year	Net Distribution by Trustees	J. D. and A. B. Spreckels Company Dividends	Net Bal. of Other Items
1940.....	\$47,695.81	\$45,560.00	\$2,135.81

The parties are agreed that the portion of the dividends of J. D. and A. B. Spreckels Company for the year 1940 which this Court determines in this case of Grace H. Kelham, Petitioner vs. Commissioner of Internal Revenue, Respondent, Docket No. 5333, have been paid out of capital will represent: (a) The portion of the amount listed in the "Total" column of Schedule A which is to be subtracted from petitioner's taxable income for the year 1940; and (b) the portion of the amount listed in the column entitled "J. D. and A. B. Spreckels Company Dividends" of Schedule B which is to

be subtracted from the amount listed in the column entitled "Net Distribution by Trustees" of Schedule B in determining petitioner's taxable income for the year 1940.

Dated this 31st day of October, 1947.

/s/ LEON de FREMERY,  
Attorney for Petitioner.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

Filed at hearing Nov. 3, 1947, T.C.U.S.

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The Tax Court of the United States  
Docket No. 5333

GRACE H. KELHAM,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Docket No. 5334

LEILA H. NEILL,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Docket No. 5495

ELLIS M. MOORE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Docket No. 5559

HARRIET H. BELCHER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Docket No. 5560

LILLIE S. WEGEFORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Promulgated December 20, 1949.

In determining earnings or profits accumulated after February 28, 1913, held that capital impaired by pre-March 1, 1913, operating losses must be restored out of subsequent earnings or profits.

Where shares of a corporation are forfeited or "bid" in for the amount of unpaid assessments or calls thereon and after being carried on the books

of the corporation as treasury shares for some years and, at a time when the corporate capital stands impaired from operating losses, are issued in consideration for the cancellation of notes of the corporation which had been given to cover advances to the corporation and accrued interest thereon, held that such issue or disposition of the treasury shares was in character a capital-producing transaction and did not result in a restoration of impaired capital through realization of profits.

Two wholly-owned subsidiary corporations having capital impaired by operating losses sustained after February 28, 1913, were dissolved in liquidations falling within section 112 (b)(6) of the Revenue Acts of 1936 and 1938. Held, that the earnings or profits of the parent corporation are not absorbed by such impairment of the capital of the dissolved subsidiaries in computing the accumulated earnings or profits of the parent corporation available for distribution as taxable dividends. *Commissioner v. Phipps*, 336 U. S. 410, followed.

LEON de FREMERY, ESQ.,

For the petitioners.

W. J. McFARLAND, ESQ., and

T. M. MATHER, ESQ.,

For the respondent.

### OPINION

Turner, Judge:

The respondent has determined deficiencies in income tax against the petitioners as follows:

Petitioner	Docket No.	1937	1938	1939	1940
Grace H. Kelham.....	5333	.....	.....	.....	\$48,658.15
Leila H. Neill.....	5334	.....	\$2,990.24	\$ 242.05	46,762.19
Ellis M. Moore.....	5495	\$6,989.38	3,274.99	2,744.62	23,499.16
Harriet H. Belcher.....	5559	.....	.....	.....	1,471.00
Lillie S. Wegeforth.....	5560	.....	711.19	1,069.75	80,032.58

Overpayments are claimed as follows:

Petitioner	1937	1938	1939
Leila H. Neill.....	.....	\$ 6,703.76	\$13,975.37
Ellis M. Moore.....	\$10,436.63	5,723.26	7,324.66
Lillie S. Wegeforth .....	.....	15,578.82	32,427.63

The petitioners, during the years 1938 through 1940, were stockholders of J. D. and A. B. Spreckels Company, hereinafter referred to as the Spreckels Company. During those years, Spreckels Company made distributions to its stockholders. The respondent has determined that those distributions, in full, were taxable dividends within the meaning of section 115 of the applicable Revenue Acts. It is the claim of the petitioners that the distributions, in part, were distributions of capital. The facts have been stipulated.

In liquidations coming within the purview of section 112(b)(6) of the Revenue Acts of 1936 and 1938, Spreckels Company had acquired all of the assets of three wholly-owned subsidiaries. Oceanic Steamship Company, sometimes referred to herein as Oceanic, and Monterey County Water Company were so liquidated in 1936. The liquidation of Seventh and Hill Building Corporation occurred in 1938. Prior to March 1, 1913, and at all times since that date, Spreckels Company and its predecessor in interest owned substantial amounts of the capital

stock of Kilauea Sugar Plantation Company, sometimes referred to herein as Kilauea, and received dividends therefrom.

The parties have agreed that the extent to which the distributions made by Spreckels Company to its stockholders during the taxable years constituted taxable dividends will be determined upon the disposition of three issues. These issues as posed by stipulation of the parties, are as follows:

1. Whether the transfer by Oceanic Steamship Company on November 16, 1912, of 23,647 shares of its stock to J. D. Spreckels & Bros. Company in consideration for the cancellation and surrender by J. D. Spreckels & Bros. Company of notes payable by Oceanic Steamship Company to J. D. Spreckels & Bros. Company reduced the operating deficit of said Oceanic Steamship Company.
2. Whether the operating deficits of Oceanic Steamship Company and Kilauea Sugar Plantation Company as of March 1, 1913, must be restored by subsequent earnings or profits in determining the amount of earnings or profits available for dividends.
3. Whether the operating deficits of Seventh and Hill Building Corporation and Monterey County Water Company, wholly-owned subsidiaries of J. D. and A. B. Spreckels Company, were transferred to J. D. and A. B. Spreckels Company at the time of the liquidation of the said wholly-owned subsidiaries.

It is stipulated that at March 1, 1913, both Oceanic and Kilauea had operating deficits, the said deficit of Kilauea being \$308,429.18, while that of Oceanic is stipulated to turn on the disposition by this Court of issue numbered one, as stated above. As to Monterey County Water Company, the parties have stipulated that at the time of its liquidation, in 1936, it had an operating deficit accumulated since March 1, 1913, in the amount of \$47,030.64. As to Seventh and Hill Building Corporation, the parties have stipulated that at the time of its liquidation, in 1938, it had an operating deficit accumulated since March 1, 1913, in the amount of \$98,594.01.

From the stipulation and the briefs of the parties, it is assumed that when referring to "operating deficits" the parties mean the amounts by which the capital of the various corporations, as of the respective dates, stood impaired by reason of operating losses. Otherwise, the use of the term "operating deficit" might well leave some doubt as to the sufficiency of the facts for the purpose of determining the character of the distributions made by Spreckels Company to the petitioners, in that in certain circumstances and as of a given period, a corporation might have an operating deficit which would in no way affect the character of the corporate distributions made to stockholders. See Helvering v. Canfield, 291 U. S. 163, affirming 24 B. T. A. 480.

Turning first to the question stated by the parties as Issue 2, it is the contention of the petitioners that Oceanic and Kilauea could have no accumulated

earnings or profits after February 28, 1913, to pass on to the Spreckels Company, until impaired capital as of that date had been restored, and, to the extent that allowance for restoration of such impaired capital was not made by the respondent in his determination, the distributions here in question were not taxable dividends, within the meaning of section 115 of the statute. To the contrary, it is the claim of the respondent that by the provisions of section 115,<sup>1</sup> particularly those parts thereof which provide that the term "dividend" "means any distribution by a corporation to its shareholders \* \* \* out of its earnings or profits accumulated after

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<sup>1</sup>Sec. 115. Distributions by Corporation.

(a) Definition of Dividend—The term "dividend" when used in this chapter \* \* \* means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. \* \* \*

(b) Source of Distributions—For the purpose of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113. \* \* \*

February 28, 1913," and that "any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed," Congress drew a line at March 1, 1913, not only as to earnings and profits accumulated or existing on that date, but likewise as to the existing state of the corporate capital on that date. On that interpretation of the statute, he argues that in computing corporate earnings accumulated after February 28, 1913, regard is to be given only to operating results after that date, and no regard is to be given to the condition or state of the corporate capital on that date.

Speaking generally, and aside from the income tax aspects of the problem, the argument of the respondent is plainly contrary to fundamental principles of corporation law. The capital of a corporation is the fund on which a corporation is to do business. It is the fund to be utilized by it in making the profits which may be distributed to its stockholders as dividends. It is the fund on which creditors and people doing business with the corporation are entitled to rely for assurance that it is an entity of financial responsibility, and, except for instances where, pursuant to statute or the provisions of its charter, a corporation is being liquidated or its capital reduced, distributions from capital are not normally to be made to stockholders, but rather the capital is to be preserved and maintained intact for the purposes for which it was paid

in. In such circumstances, certain basic and fundamental principles of law have been evolved, to the end that dividends may "be declared only out of surplus profits,"<sup>2</sup> and further, "there cannot be surplus or net profits for the purpose of declaring a dividend, unless the total value of the assets of the corporation at the time it is proposed to declare the dividend exceed the amount of its capital stock, after deducting all expenses which have been incurred, and all losses which have been sustained. \* \* \* In determining whether there are net profits from which dividends must be declared the capital must be regarded as a liability."<sup>2</sup> And where the capital of a corporation has been impaired or consumed through operations, it follows as a matter of fact and logic that even though subsequent operations result in profits, there can be no "surplus or net profits" in excess of the capital fund until the capital fund has been restored or made whole. And while under general corporation law it does appear that such restoration may, in some circumstances, be accomplished through appreciation in the value of assets, there is no such factor in this case.

Beginning with the Act of October 3, 1913, the first of the Federal income tax statutes enacted after ratification of the Sixteenth Amendment to the Constitution, dividends have, by specific statutory provision, always constituted gross income to an individual. The act contained no definition or

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<sup>2</sup>Sections 5329 and 5335, Vol. 11, Fletcher's Cyclopedic of the Law of Private Corporations.

limitation of the term "dividend." In the Revenue Act of 1916, however, the term "dividend" was limited to distributions made or ordered to be made by a corporation out of its earnings or profits accumulated after February 28, 1913. In the Revenue Act of 1917, provision was made that any distributions made to the shareholders of a corporation should be deemed to have been made from the most recently accumulated undivided profits or surplus and should constitute a part of the annual income of the distributee for the year in which received: provided, however, that the provision be not construed as taxing earnings or profits accrued prior to March 1, 1913. Except for changes in phraseology, the statute remained in that form until the Revenue Act of 1936, when the provision limiting taxable dividends to distributions made by a corporation to its shareholders out of its earnings or profits accumulated after February 28, 1913, was amended to provide that taxable dividends should likewise include distributions "out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made." Such was the state of the statute during the taxable years here involved.

In due course, after the enactment of the Act of October 3, 1913, the Supreme Court had before it, in *Lynch v. Hornby*, 247 U. S. 339, the question whether, under the statute and the Constitution,

distributions made by a corporation to its shareholders from a surplus of corporate assets existing at March 1, 1913, were as to the stockholders taxable income. In that case, the corporation, at March 1, 1913, had surplus assets of \$3,000,000. In 1914, it made a distribution of \$650,000 to its stockholders, of which \$240,000 was from current earnings and the remaining \$410,000 was from the conversion into money of property it had owned, or in which it had had an interest, on March 1, 1913. The question was whether that portion of the distribution representing the \$410,000 was income to the stockholders. In resolving that question for the Government, the Court said:

\* \* \* And we deem it equally clear that Congress was at liberty under the amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the amendment, including dividends received in the ordinary course by a stockholder from a corporation, even though they were extraordinary in amount and might appear upon analysis to be a mere realization in possession of an inchoate and contingent interest that the stockholder had in a surplus of corporate assets previously existing. Dividends are the appropriate fruit of stock ownership, are commonly reckoned as income, and are expended as such by the stockholder without regard to whether they are declared from the most recent earnings, or from a surplus accumulated from the earnings of the

past, or are based upon the increased value of the property of the corporation. The stockholder is, in the ordinary case, a different entity from the corporation, and Congress was at liberty to treat the dividends as coming to him *ab extra*, and as constituting a part of his income when they came to hand.

Hence we construe the provision of the act that "the net income of a taxable person shall include gains, profits, and income derived from \* \* \* interest, rent, dividends, \* \* \* or gains or profits and income derived from any source whatever" as including (for the purposes of the additional tax) all dividends declared and paid in the ordinary course of business by a corporation to its stockholders after the taking effect of the act (March 1, 1913), whether from current earnings, or from the accumulated surplus made up of past earnings or increase in value of corporate assets, notwithstanding it accrued to the corporation in whole or in part prior to March 1, 1913. In short, the word "dividends" was employed in the act as descriptive of one kind of gain to the individual stockholder; dividends being treated as the tangible and recurrent returns upon his stock, analogous to the interest and rent received upon other forms of invested capital.

After concluding, as shown above, that the term "dividend" was to be given its usual and ordinary meaning, the Court took note of the fact that Con-

gress, in the Revenue Act of 1916, had limited the term to mean distributions made by a corporation out of its earnings or profits accumulated since February 28, 1913, and indicated that it regarded the amendment merely as a concession to the equity of stockholders with respect to distributions from earnings accumulated at March 1, 1913, and as to which stockholders had no constitutional immunity, rather than as being otherwise declaratory of the meaning of the term "dividend." Certainly, as a general matter, a stockholder may not be regarded as having an equity in the impairment of corporate capital so as to be entitled to distributions from corporate earnings before capital has been restored.

As to the impairment of capital or paid-in surplus accruing after February 28, 1913, as a result of operating losses, the law is well settled, and the respondent concedes, that capital must be restored to the extent of such impairment out of earnings or profits before there can be any accumulation of earnings or profits after February 28, 1913, for distribution as a taxable dividend. *Foley Securities Corporation*, 38 B. T. A. 1036, affd., 106 Fed. (2d) 731; *Commissioner v. W. S. Farish & Co.*, 104 Fed. (2d) 833; *Hadden v. Commissioner*, 49 Fed. (2d) 709; *Roy J. Kinnear*, 36 B. T. A. 153, Petition for Review dismissed, 95 Fed. (2d) 997; *Loren D. Sale*, 35 B. T. A. 938; and *Arthur C. Stifel*, 29 B. T. A. 1145. Turning to the opinions in these cases, it seems to us plain and clear that the reasoning back of the conclusion that post-February 28, 1913, impairments of capital must be restored out of the

earnings or profits before there can be any accumulation of earnings or profits from which taxable dividends can be paid, equally demonstrates and shows that there can be no accumulation of post-February 28, 1913, profits, for the purpose of distributing taxable dividends, until impaired capital at March 1, 1913, has been restored.

In *Commissioner v. W. S. Farish & Co.*, *supra*, the court said: "It is well settled that impairment of capital or paid in surplus of a corporation which resulted from operating losses must be restored before any earnings can be available for distribution to the stockholders. *Willcuts v. Milton Dairy Co.*, 275 U. S. 215." In *Milton Dairy Co.*, the Supreme Court, while dealing with the question of the existence of undivided profits, for invested capital purposes, nevertheless very plainly disclosed its views as to the existence not only of undivided profits, but of surplus profits available for distribution as a dividend, wherein it said: "But it is a prerequisite to the existence of 'undivided profits' as well as a 'surplus' that the net assets of the corporation exceed the capital stock. Hence, where the capital is impaired, profits, though earned and remaining in the business, if insufficient to offset this impairment do not constitute 'undivided profits.' \* \* \* We do not think Congress intended that a corporation whose capital was impaired should be entitled to treat profits that, though earned, were insufficient to make good the impairment and create a surplus, as 'undivided profits.' "

In Loren D. Sale, *supra*, we had occasion to consider the question of impairment of capital occurring after February 28, 1913, and in concluding that capital must be restored to the extent of such impairment before there can be any accumulation of earnings or profits available for distribution as a taxable dividend, we said:

There is a rule of law that every impairment of capital or paid-in surplus resulting from operating losses must be restored before any earnings can be available for the distribution of a taxable dividend within the meaning of section 201 (a) of the Revenue Act of 1924. *Crystal Ice Co.*, 14 B.T.A. 682; *J. L. Washburn*, 16 B.T.A. 1091; *Arthur C. Stifel*, 29 B.T.A. 1145; *Willcuts v. Milton Dairy Co.*, 275 U. S. 215. \* \* \*

\* \* \*

The statute does not provide that impaired capital or paid-in surplus must be restored before earnings are available for the distribution of a taxable dividend. That rule of law was laid down by the Board and the courts, which had in mind the fundamental principle that a corporation, the capital of which had been impaired by losses, can never have any accumulated earnings until its capital is restored. Corporations, of course, were well known long before March 1, 1913, the effective date of the income tax. Likewise, the concepts of capital and impairment of capital were fixed in the

law and generally understood. The provisions of the revenue acts have not changed the law in respect of capital or impairment of capital. Those acts, however, allowed for certain purposes the use of the fair market value on March 1, 1913, of property acquired prior thereto instead of the lower cost of such property. For example, in the computation of gain or loss giving rise to income or deductions, corporations could use March 1, 1913, value, regardless of what would have been the situation had they used cost as a basis. But in the determination of whether or not the capital of a particular corporation has been impaired, there is, so far as we know, on good reason or authority for using the fair market value on March 1, 1913. \* \* \*

The respondent cites and relies upon *Hoffman v. United States* (Ct. of Clms.), 53 Fed. (2d) 282. That case, in reality, however, was a case involving the computation of distributions made after February 28, 1913, from an increase in the value of property accruing before March 1, 1913. It is true that in the course of its opinion the Court of Claims cited, with apparent approval, its previous opinion in *Blair v. United States*, 63 Ct. Cl. 193, and the *Blair* case, on its face, does seem to stand for the proposition that, under the Revenue Act of 1917, where a corporation had current earnings and made a distribution to its stockholders, such distributions constituted taxable dividends, within the meaning

of the statute, without regard to whether or not there was an impairment of capital. The Court did not seem to concern itself with the proposition whether there was impairment of capital before or after March 1, 1913, or both. In *J. L. Washburn*, 16 B.T.A. . . ., we had occasion to consider the *Blair* case, and, with all due respect to the Court of Claims, concluded that it did not represent sound law and declined to follow it. In *Foley Securities Corporation v. Commissioner*, *supra*, the Circuit Court of Appeals for the Eighth Circuit took note of our views as to the *Blair* case, and affirmed us in our conclusion, saying: "It seems to us obvious that the ruling of the Board and of the Commissioner as to what constitutes a 'dividend' under the definition of that term contained in Section 115 (a) must be accepted as correct. It follows that the distribution which was made by the taxpayer to its shareholders in 1934 was a 'dividend' only to the extent that it exceeded the operating deficit due to losses in prior years." In so holding, it is to be noted that the Circuit Court of Appeals accepted as authority in the matters the declaration of the Supreme Court in *Willcuts v. Milton Dairy Co.*, *supra*.

The case of *Chapman v. Anderson*, 11 Fed. Supp. 913, cited and relied on by the petitioners, seems to be directly in point. The respondent takes the position that the case is of no force here, in that the question involved was whether or not a book write-up in 1925 of the value of the corporate assets as of March 1, 1913, should be regarded as restoring

capital which had been impaired by pre-March 1, 1913, operating deficits, so as to render taxable dividends paid by the corporation in 1925 and 1926. While it is true that that was the particular question and the court did conclude that the write-up of the assets on the books of the corporation as of March 1, 1913, did not restore the capital impaired, the ultimate question decided was that since the March 1, 1913, impairment of capital had not been restored out of subsequent earnings, distributions made from current profits were not taxable dividends to stockholders. In so holding, the court said that "unless an operating deficit or impairment of capital has been made good out of subsequent earnings or profits, any distribution of stock is not a 'dividend' under 26 U.S.C.A., section 932." The court there likewise looked to the Supreme Court's opinion in *Willcuts v. Milton Dairy Co.* for support, and also quoted from the opinion of the Court of Appeals for the Second Circuit, in *Hadden v. Commissioner*, *supra*, as follows: "Congress did not intend that a corporation should be held to accumulate profits for one tax purpose only and not for another. No earned surplus can be accumulated until the deficit or impairment of paid-in capital has been made good. Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part."

The reasoning of the various courts in reaching the conclusion that post-February 28, 1913, impairment of capital must be restored before there can be any accumulation of profits available for distribution to stockholders as dividends, seems to us equally applicable to impairment of capital whenever suffered or sustained, and that the statutory provision providing that pre-March 1, 1913, earnings or profits may be distributed, tax free, in no way affects the general rule stated and gives no basis for any conclusion that Congress, in recognizing, as the Supreme Court stated in *Lynch v. Hornby*, *supra*, the equity of stockholders as to pre-March 1, 1913, earnings, intended to legislate with respect to restoration or non-restoration of capital which has been impaired by operating losses. This view, in our opinion, is further supported by the Supreme Court in its treatment of the problem involved in *Helvering v. Canfield*, *supra*. In that case, the corporation had accumulated earnings and profits at March 1, 1913. These earnings and profits were dissipated by subsequent operating losses. Thereafter the corporation had earnings and profits from which distributions were made to its stockholders, and the question was whether or not, under the statutory provision that distributions of pre-March 1, 1913, earnings or profits were tax free, the post-February 28, 1913, earnings and profits must first be applied to absorb the loss of the pre-March 1, 1913, profits before there could be any accumulation of earnings or profits after February 28, 1913,

for distribution as a taxable dividend. The Court answered the question in the negative, pointing out that the fact that pre-March 1, 1913, profits were lost through operations supplied no basis for permitting profits accumulated after that date to escape, and in stating its conclusion therein, the Court took pains to point out that it was not there "concerned with capital in the sense of fixed or paid-in capital, which is not to be impaired, or with the restoration of such capital where there has been impairment."

The respondent makes one further argument, which is, that since the enactment of the Revenue Act of 1936, taxable dividends include distributions out of earnings or profits of the current year, computed as of the close of the taxable year, irrespective of a deficit existing at the time the distribution was made, and contends that since section 115 (a) of the Code makes no distinction between earnings or profits accumulated after February 28, 1913, and earnings or profits of the current year, as to taxability of distributions therefrom, there is no valid basis for adopting a statutory interpretation that would require restoration of an impairment of capital existing on March 1, 1913, out of earnings or profits realized on or after that date. The provision referred to first appeared in the Revenue Bill of 1936, as reported to the Senate by the Senate Finance Committee, and was enacted into law in the language which appeared in the bill. Respecting this provision, the Senate Finance Committee Report, Report No. 2156, 74th Congress, 2nd Session, page 18, contains the following:

**Section 115 (a). Dividends Out of Current Earnings**

In order to enable corporations without regard to deficits existing at the beginning of the taxable year to obtain the benefit of the dividends-paid credit for the purposes of the undistributed-profits surtax, section 115 (a) changes the definition of a dividend so as to include distributions out of the earnings or profits of the current taxable year. The amendment simplifies the determination by providing that distributions during the year, not exceeding in amount the current earnings, are dividends constituting taxable income to the shareholder and a dividends-paid credit to the corporation. As respects such dividends the complicated determination of accumulated earnings or profits is rendered unnecessary.

The language of the committee report indicates that as respects "earnings or profits accumulated after February 28, 1913" (emphasis ours), no change was intended in the law as it had been in prior acts, and that as to such distributions "regard to deficits existing at the beginning of the taxable year" and the "complicated determination of accumulated earnings or profits" would still be required. Only distributions from, and up to the amount of, the current earnings of the taxable year were intended to be freed of such requirements. The report, in recognizing the requirement for regard to deficits in the determination of earnings or profits accumulated after February 28, 1913, makes no distinction between deficits which arose prior to March 1, 1913, and those which arose after-

wards. A further answer to the contention of the respondent is that we are not here concerned with distributions made by an impaired capital corporation out of current earnings for the taxable years.

From the above, we think it follows that there can be no accumulation of profits until impaired capital has been restored. There is a difference, we think, between the realization currently of earnings and profits and the accumulation thereof. In other words, there can be no accumulation of earnings where profits, as earned, are absorbed in restoration of capital which has been impaired through previous operating losses, and it seems to us fundamental that it matters not whether the impairment occurred before or after March 1, 1913. It is accordingly our conclusion that the petitioners must be sustained in their contention that, in computing the accumulated profits of Oceanic and Kilauea after February 28, 1913, allowance must be made for the impairment of capital of those two corporations as of March 1, 1913.

In view of the conclusion above, it now becomes necessary to determine the issue stated by the parties as Issue 1, which is whether the transfer by Oceanic on November 16, 1912, of 23,647 shares of its capital stock to J. D. Spreckels & Bros. Company, in consideration for the cancellation of notes of Oceanic, reduced the amount by which Oceanic's capital had been impaired by operating losses.

Oceanic was incorporated under the laws of California, on December 24, 1881, with an authorized capital of 25,000 shares of common stock of \$100

par value per share. Payment of the subscription price of \$100 per share for the original 25,000 shares of stock issued was made upon calls by the corporation over a period of twenty years. These calls were described in the books of account as "assessments." By the end of 1902, the original issue of stock was fully paid, \$2,500,000 in cash having been received therefor. On April 29, 1903, an additional 25,000 shares of stock, of the par value of \$100 per share, was authorized, and was issued on April 30, 1903, to stockholders of record, pro rata. Upon the issuance of this stock, the capital stock account was credited with \$2,500,000 and an account entitled "Stock Bonus Account" was debited in like amount, and at all times thereafter the capital stock account remained on Oceanic's books at \$5,000,000. "At the date of this transaction the corporation had a deficit in excess of \$1,500,000, of which approximately \$750,000 resulted from operations of the business." Assessments were thereafter levied by the corporation on all shares of outstanding stock alike, whether of the original or second issue. After assessments were levied, like amounts were credited to the Stock Bonus Account. Altogether there were six such assessments, the first at \$2 per share and the others at \$10 per share. In each of the first four levies some shares failed to pay the assessments thereon. All shares on which assessments were not paid, were "bid" in by the corporation for the amount of the unpaid assessments, and in the case of the next assessment made, the assessments were made only on the shares left outstanding. The last of the six

assessments was made on October 3, 1907. As a result of the assessments, a total of \$1,393,654 was paid in, which, with the \$2,500,000 paid in for the original 25,000 shares, made \$3,893,654 as the total capital paid in to Oceanic for or on its stock. The number of shares left outstanding was 26,353, whereas 23,647 had been "bid" in by Oceanic for failure to pay assessments totaling \$132,846. The 23,647 shares were not cancelled, but were reissued in the name of Oceanic and were thereafter carried on its books as treasury stock, in the amount of \$134,210.26, being the unpaid assessments of \$132,846, plus \$1,364.26 representing "charges in connection therewith." The exact nature of the charges is not shown.

Over the years, J. D. Spreckels & Bros. Company advanced moneys for financing the activities of Oceanic. At November 16, 1912, that company held the notes of Oceanic in the amount of \$1,204,070.48, covering the advances and accrued interest. There was also accrued on that date interest on the notes in the amount of \$79,623.91. According to the books of J. D. Spreckels & Bros. Company, \$1,113,732.50 represented the amount of advances, whereas the balance of the face amount of the notes represented accrued interest on the advances. On November 16, 1912, Oceanic issued or transferred the 23,647 shares of its stock then carried on its books as treasury stock to J. D. Spreckels & Bros. Company, in consideration for the cancellation and surrender to it by J. D. Spreckels & Bros. Company of the notes of Oceanic in the principal amount of \$1,204,070.48,

together with accrued interest in the amount of \$79,623.91. On the same date a certificate for the said shares was issued to J. D. Spreckels & Bros. Company.

As a result of the above transaction, Oceanic made the following entries on its books of account: "On November 16, 1912, it charged 'Bills Payable' with the principal sum of said notes in the amount of \$1,204,070.48 and charged 'Interest Accrued on Notes' with the accrued interest thereon in the amount of \$79,623.91, the total of these two items in the amount of \$1,283,694.39 being credited to an account entitled 'Deficiency'; and the Treasury Stock account was credited with the balance remaining in said account in the amount of \$134,210.26 and this amount was charged to said 'Deficiency' account. On December 31, 1912, the balance of \$973,500.00 remaining in the stock bonus account was written off and this amount was charged to said 'Deficiency' account."

From its incorporation in 1892, to September 26, 1912, the stock of J. D. Spreckels & Bros. Company was entirely owned by J. D. and A. B. Spreckels, in equal amounts. On September 26, 1912, the said stock was transferred by the brothers, along with other property, to J. D. and A. B. Spreckels Securities Company in exchange for all of its capital stock. J. D. and A. B. Spreckels Securities Company was the predecessor of Spreckels Company. The parties have stipulated that the capital stock of Oceanic was worthless as of September 26, 1912.

The acquisition and disposition of the 23,647 shares of capital stock were the only transactions Oceanic ever had in its capital stock, other than the original issuance thereof.

On the facts, it is the contention of the respondent that Oceanic realized a gain of \$1,149,484.13, or otherwise reduced its operating deficit by that amount, upon the transfer of the 23,647 shares of its capital stock to Spreckels Company. The respondent arrives at the said amount as follows:

Principal amount of notes cancelled . . . . .	\$1,204,070.48
Accrued interest thereon . . . . .	79,623.91
<hr/>	
	1,283,694.39
Less bid in price on delinquent stock sales . . . . .	134,210.26
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	\$1,149,484.13

The petitioners contend that the said transaction was a capital transaction, which did not result in any realization of gain or otherwise reduce the operating deficit of Oceanic.

The facts as to Oceanic disclose rather unorthodox capital financing. The original issue of 25,000 shares of \$100 par value stock was subscribed for and in due course paid for in cash. Thereafter, and at a time when its capital was impaired, 25,000 additional shares of stock were authorized and issued to stockholders pro rata and book entries were made to show corporate capital at \$5,000,000, even though

no part of the additional \$2,500,000, to offset the increase in the capital stock account, was paid in. Instead a "Stock Bonus Account" of \$2,500,000 was set up, which, in the absence of other facts, might tend to indicate that the stockholders had subscribed for the added 25,000 shares of stock pro rata, at par, and that payment of the subscriptions would be made on calls by the corporation over a period of time, as was done in the case of the original 25,000 shares. The facts show, however, that such was not the case, but that thereafter assessments were levied, not on the new issue of 25,000 shares of stock, but on all shares equally, whether of the fully-paid original shares or the new shares. Six levies were made in all, and in each of the first four levies some shares failed to meet the assessments and the shares were taken over, "bid" in or forfeited, until at the conclusion of the six levies there were actually outstanding only 26,353 shares of stock and there had been paid in for the original 25,000 shares and on assessments a total of \$3,893,-654. The fact that the corporation saw fit to place the "bid" in shares on its books as treasury stock, at the amount of the unpaid assessments, plus a small amount of unexplained costs, for which the shares were forfeited or "bid" in, and further saw fit to continue these shares at par in its capital stock liability account, in no way changes the actual factual picture. Regardless of bookkeeping entries indulged in, the facts were that there had been paid in on capital stock a total of \$3,983,654 and there

were outstanding only 26,353 shares of stock of a total par value of \$2,635,300. In other words, the net result of the issue of the additional shares of stock, the levies and collection of the assessments and the forfeiture or "bidding" in of the shares on which the assessments were not paid, was that additional payments on stock totaling \$1,393,654 were received, with a net increase in shares of stock actually outstanding of only 1,353 shares, having a total par value of only \$135,300. It thus appears that to the extent of the amounts which had been paid in on the forfeited shares Oceanic had received substantial amounts as paid-in capital, but as to the forfeited shares, it no longer had any capital stock liability, the over-all result being that the financial condition of both Oceanic and the holders of the 26,353 shares of outstanding capital stock had been substantially improved. In that situation, it might, with some force, be contended that the payments which had been made on the forfeited or "bid" in shares were, by such acquisition of shares, converted from capital to profits, thereby effecting a restoration of impaired capital or resulting in surplus profits available for distribution as dividends. The respondent, however, has advanced no such theory, and furthermore, under the general law of corporations, amounts which have been paid on forfeited shares may not be regarded as surplus profits, subject to distribution as dividends, or applied in restoring impaired capital, though when related to the reduction in capital stock still outstand-

ing there may have seemed to have been a realization of profits by the corporation.<sup>3</sup> A statement of the general rule is found in section 5345, Volume 11, Fletcher's Cyclopedic of the Law of Private Corporations, which reads, in part, as follows:

§5345.—Property or money representing capital stock.

Property or money which represents an investment of the capital stock of a corporation, or of any part thereof, cannot be regarded as surplus profits, and distributed as dividends, irrespective of the financial condition of the corporation. When a person subscribes for or purchases shares of stock in a corporation, and pays a part only of the amount due thereon, and the shares are afterwards forfeited for non-payment of the balance, the amount paid is not profits, but a part of the capital, and cannot be divided among the stockholders. And the same is true of the proceeds of the sale by the corporation of shares of its own stock not previously issued, and of money paid into the treasury of the corporation by certain of its stockholders for the purpose of strengthening

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<sup>3</sup>For cases where the question was whether a corporation realized taxable income upon forfeiture of shares for failure to pay the full amount of the subscriptions therefor, see *Realty Bond Mortgage Co. v. United States* (Ct. of Clms.), 16 Fed. Supp. 771; *Commissioner v. Inland Finance Co.*, 63 Fed. (2d) 886, affirming 23 B. T. A. 199; and *Illinois Rural Credit Association*, 3 B. T. A. 1178.

the company and adding to its working capital, and for which no additional stock is issued.

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The stockholders of a corporation have the right to a division of its capital among them, after payment of its debts, when the corporation has been dissolved.

Nor is the rule questioned that a surplus arising from a lawful reduction of the capital stock is available for dividend purposes and may be lawfully distributed as such. The fund thus distributed is sometimes called a 'dividend,' but it is very different from a dividend out of profits.

Whether or not the parties have based their alternate computations of the "operating deficit" of Oceanic on paid-in capital of \$3,893,654 as of the date of issuance of the 23,647 shares to J. D. Spreckels & Bros. Company, on November 16, 1912, is not at once apparent. Inasmuch, however, as the issue as to the amount of the "operating deficit" at March 1, 1913, has been submitted by stipulation of the parties on the narrow proposition whether the issuance of the 23,647 shares in consideration of the cancellation of Oceanic's notes and the accrued interest thereon resulted in gain to Oceanic or otherwise reduced its "operating deficit," we have no occasion to look behind the stipulated results, however computed.

The 23,647 shares of stock were carried on the books of Oceanic as treasury stock. Treasury

shares are presently defined in section 278 of the Civil Code of California as "shares issued and thereafter acquired by the corporation, but not re-tired or restored to the status of unissued shares." And while the authorities are not in complete agreement as to the procedure or method whereby a corporation may properly acquire and thereafter hold its shares as treasury stock, they do seem to agree that the holding of such shares is for use or disposition by the corporation "in furtherance of corporate purposes," or, differently stated, is for the purpose of subsequent sale to procure working capital. See section 5099, Volume 11, Fletcher's Cyclo-pedia of the Law of Private Corporations; *Borg v. International Silver Co.*, 11 Fed. (2d) 147; *Shores v. Dakota-Montana Oil Co.* (N. D.), 237 N. W. 172; *Maynard v. Doe Run Lead Co.* (Mo.), 265 S. W. 94; *State ex rel, Moore v. Manhattan Verde Co.* (Nev.), 109 Pac. 442. An apt analysis of the character and substance of treasury shares is given by Justice Learned Hand, in his opinion in *Borg v. International Silver Co.*, *supra*, wherein he said, "To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant [the corporation] cannot collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry

them as an asset at cost, providing, of course, all other assets are so carried. \* \* \* In any event there can be no ambiguity in stating the facts more directly \* \* \*; that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal account or not."

That the issuance of the 23,647 shares to J. D. Spreckels & Bros. Company on November 16, 1912, was in character a capital-producing transaction and in no way resulted in the realization of gain or a restoration of Oceanic's impaired capital, is not, in our opinion, open to doubt. Looking to realities, the acquisition of these shares was not the purchase by Oceanic of an asset. While they are described as having been "bid" in for the amount of the unpaid assessments against them, and Oceanic carried them at a book cost equal to the amount of such unpaid assessments, plus a small amount of unexplained expenses, the effect of their acquisition was that of forfeiture for failure to pay the assessments or calls against them, made apparently in accordance with the terms of their original issue. In their reacquisition there was no outgo from either capital or profits, and the cost figures on Oceanic's books were accounting entries, nothing more. Certainly, on the facts here, these shares in the hands of Oceanic had no function or substance, and served no purpose, except for future sale or issue for the production of capital, with the attendant result that upon sale or

issue they would likewise become an added capital stock liability. In order for the transaction to result in a realization of gain or otherwise reduce Oceanic's "operating deficit," as the respondent contends, it seems to us inescapable that Oceanic must come out of the transaction with either an increase in assets over what it had before and without an attendant increase in liabilities, or the assets which it did have must have been freed or released, to some extent, of the liabilities which enter into the computation of capital and surplus. Plainly no such results ensued. To put the transaction in its best light, from the standpoint of the respondent, it, at the most, resulted in change of a notes payable and accrued interest liability into a capital stock liability of equal or greater amount. In determining whether there are net profits from which dividends must be declared, the capital stock liability must be taken into account, just as would a notes payable liability. Section 5335, Volume 11, Fletcher's *Cyclopedia of the Law of Private Corporations*, *supra*. Such being the case, the change here could not possibly have resulted in gain or in the restoration of impaired capital. In reaching this conclusion, we do not overlook the cases wherein it has been decided that a corporation may, and in some instances has, realized taxable gain upon the acquisition and resale of its own shares. See and compare *The M. Conley Co.*, 6 T. C. 250; *Rollins Burdick Hunter Co.*, 9 T. C. 169; *Cluett, Peabody & Co.*, 3 T. C. 169; *Dr. Pepper Bottling Company of Mississippi*, 1 T. C. 8. Neither do we decide that a

corporation may not traffic in its own shares in such manner that some part of the proceeds from a resale of such shares would properly go to profits, rather than to the enhancement of its capital fund. We do conclude, however, that such was not the result of the transaction here in question.

The last issue presents the question whether upon liquidation of Monterey County Water Company and Seventh and Hill Building Corporation, wholly-owned subsidiaries of Spreckels Company, deficits resulting in impairment of capital after February 28, 1913, were, under the rule in *Sansome v. Commissioner*, 60 Fed. (2d) 931, continued as a deficit to Spreckels Company which would have to be restored out of Spreckels Company profits in computing the earnings and profits of Spreckels Company after February 28, 1913. The Monterey County Water Company was dissolved on November 18, 1936, and on that date its capital was impaired by reason of operating losses after March 1, 1913, in the amount of \$47,030.64. Seventh and Hill Building Corporation was dissolved on December 13, 1938, and when dissolved, its capital was impaired by operating losses sustained after February 28, 1913, in the amount of \$98,594.01.

These liquidations were within the meaning of section 112 (b) (6) of the Revenue Acts of 1936 and 1938, respectively, which provides for the non-recognition of gain or loss upon such transactions.

On authority of *Commissioner v. Phipps*, 336 U. S. 410, reversing 167 Fed. (2d) 117, we hold that the

operating deficits of the above-mentioned subsidiaries transferred upon their liquidation to the parent company do not serve to reduce the latter's accumulated earnings or profits available for distribution as taxable dividends in the years involved herein. Effect thereto, and also effect to the appropriate schedules contained in the stipulation, will be given in the recomputation under Rule 50.

The extent to which the distributions made by Spreckels Company in 1938, 1939 and 1940 were paid out of its earnings or profits available for distribution as dividends, will be determined pursuant to this opinion and the appropriate schedules contained in the stipulations, under Rule 50.

Review by the Court.

Decisions will be entered under Rule 50.

Tyson, J. concurring:

I agree with the result reached in the majority opinion on the first and third issues. I also agree with the result reached on the second issue that Oceanic's acquisition and subsequent disposition of shares of its own capital stock were a capital transaction which did not result in the realization of profits or otherwise reduce the then existing impairment of capital of Oceanic. However, I do not agree that the record establishes the existence of the basic fact upon which the opinion's rationale on this issue is predicated; that fact being that the shares of stock against which the assessments had been levied were acquired by Oceanic by forfeiture. That the rationale of the opinion is based on such a basic fact

is clearly shown by a statement in the opinion made, after citation of authorities as to the effect of forfeiture of stock and some subsidiary questions. That statement is as follows:

\* \* \* Looking to realities, the acquisition of these shares was not the purchase by Oceanic of an asset. While they are described as having been "bid" in for the amount of the unpaid assessments against them, and Oceanic carried them at a book cost equal to the amount of such unpaid assessments, plus a small amount of unexplained expenses, the effect of their acquisition was that of forfeiture [Emphasis supplied] for failure to pay the assessments or calls against them, made apparently in accordance with the terms of their original issue. In their reacquisition there was no outgo from either capital or profits, and the cost figures on Oceanic's books were accounting entries, nothing more. \* \* \*

If it were shown as a fact that the shares in question were acquired by Oceanic by forfeiture, as the majority opinion finds they were, I would not disagree with the rationale of that opinion on the second issue. However, not only is the fact that Oceanic acquired the shares by forfeiture not shown by the record, but also they are affirmatively shown to have been acquired by purchase and not by forfeiture, since the written stipulation of the parties on this point is as follows:

The shares of stock on which the assessments listed in the preceding schedule had not been paid were bid in by the corporation pursuant to delinquency sale [Emphasis supplied] and thereafter carried on its books as treasury stock in the amount of \$134,210.26. Said \$134,210.26 represented the total of the unpaid assessments for which these shares were bid in together with charges in connection therewith. \* \* \*

From the above quoted stipulation it clearly appears that the assessed shares were acquired by Oceanic by purchase for a consideration, and this being so, I think that proper consideration of this issue can be had only on the established facts: (1) That there was a purchase of the assessed shares by Oceanic, and (2), of course, that there was a resale of them thereafter by Oceanic. When so considered I think disposition of the issue should be in favor of the petitioners under authority of a long line of cases holding that, as a general rule of law, when a purchase and subsequent resale of its own stock are made by a corporation no gain or loss to the corporation is realized thereby. Simons & Hammond Manufacturing Co., 1 B. T. A. 803, a leading case; Cooperative Furniture Co., 2 B. T. A. 165; Atlantic Carton Corporation, 2 B. T. A. 380; Hutchins Lumber & Storage Co., 4 B. T. A. 705; Farmers Deposit National Bank, 5 B. T. A. 520; H. S. Crocker Co., 5 B. T. A. 537; Interurban Construction Co., 5 B. T. A. 529; Liberty Agency Co., 5 B. T. A. 778; Union Trust Co. of New Jersey, 12 B. T. A. 688; and 105 West 55th Street, Inc., 15 B. T. A. 210.

There is no question that the transaction here in-

volved is not one where "a corporation deals in its own shares as it might in the shares of another corporation" even if the principle set out in these words in the amendment of May 2, 1934, to the regulations applied to the transactions here involved which took place many years before the date of the amendment, for the reasons that: Oceanic purchased its own shares at a delinquency sale necessitated by failure of some of its stockholders to pay assessments levied on their stock; Oceanic held the purchased shares comprising almost one-half of its total authorized and issued stock as treasury stock for a period of six or seven years before its resale; when the resale was made Oceanic was insolvent and its shares were worthless; and no other purchases or sales of its own shares were ever made by Oceanic, except in the sale of its original issues.

Briefly stated, the error in the majority opinion on this issue is, I think, that it has applied a principle of law premised upon a basic fact, i.e., that Oceanic acquired the assessed stock by forfeiture—which fact is affirmatively shown not to have existed—whereas, I think a different principle of law should be applied and premised upon the real facts affirmatively shown to have existed, i.e., that Oceanic acquired the stock by purchase at the delinquency sale and thereafter sold the stock thereby bringing the transactions within the general rule of law established by the above cited authorities, that a corporation realizes no gain from a purchase and resale of its own stock.

Leech, J., agrees with this concurring opinion.

Disney, J., dissenting:

I can not agree with the majority that in determining earnings or profits accumulated after February 28, 1913, pre-March 1, 1913, operating deficits impairing capital must be restored out of subsequent earnings or profits.

We are here concerned not with a corporation or its accounting methods, but with the taxation of a stockholder who has received distribution of corporate earnings which were actually earned since February 28, 1913. In my opinion, such stockholder is taxable thereon, under clear legislative mandate.

The majority opinion cites various cases which in nowise involve or decide the present question: Foley Securities Corporation, 38 B. T. A. 1036; aff'd., 106 Fed. (2d) 731, involved dividends paid credit of a personal holding company, and distinguishes the present situations by holding that there is no accumulation of earnings or profits until an operating loss is made good "*if incurred after March 1, 1913.*" (Italics supplied.) The corporation therein was organized in 1928, so our question could not there occur. The same is true of Arthur C. Stifel, 29 B. T. A. 1145, and Commissioner v. W. S. Farish & Co., 104 Fed. (2d) 833. In Roy J. Kinnear, 36 B. T. A. 153, there was on March 1, 1913, a paid-in surplus of about \$2,500,000, and the question was the effect of later operating losses. Loren D. Sale, 35 B. T. A. 938, involved a stipulation of operating loss for the period after March 1, 1913, computed on March 1, 1913, values, and it was held that such

stipulation does not show that capital or paid-in surplus was ever impaired. So the present question as to restoration of lost capital out of subsequent earnings was not at issue. In *Crystal Ice Co.*, 14 B. T. A. 682, relied on by the Sale case, *supra*, though the corporation was organized in 1912, there was from organization up to December 31, 1914, an earned surplus of about \$23,000 and the deficits involved were incurred later. In *J. L. Washburn*, 16 B. T. A. 1091, also cited in the Sale case, it appears that the deficit involved was incurred in 1923. Obviously such cases do not reach our difficulty here, and I find no help in them. *Hadden v. Commissioner*, 49 Fed. (2d) 709, also so cited, is indeed to the contrary, for examination thereof reveals that the corporation had, as in this case, an operating deficit, up to March 1, 1913, of about \$500,000, and from that date to April 30, 1917, an operating loss of \$329,-549.22. Yet in computing corporate earnings and profits on the question of taxability of dividends the Court subtracted, from later earnings, only the \$329,549.22 and not the \$500,000. That this was intended is shown in the following language:

\* \* \* Operating losses sustained *after March 1, 1913*, must be deducted from profits realized after that date before they can be a taxable profit \* \* \*. (Italics supplied.)

The Court says this, and, as above seen, does not deduct pre-March 1, 1913, operating loss, though in the previous sentence it had broadly said:

\* \* \* Dividends paid while there is an operating deficit should be deemed to be from capital or paid-in surplus \* \* \* .

This generality, shown so to be by the Court's next language, above quoted, and its action, appears to be the ratio decidendi of the majority here, i.e., that as a general proposition dividends paid in the face of an operating deficit should be regarded as from capital, or paid-in surplus. With this broad concept I do not disagree. But we here have a question of the effect for income tax purposes of the date March 1, 1913, and what Congress intended. Neither the general concept, nor cases involving only post-March 1, 1913, deficits afford us light. Indeed such cases, above distinguished, seem inherently based upon the idea that, within the intendment of "earnings or profits accumulated after February 28, 1913," there was no accumulation, because no net accumulation, due to deficits within that period. This is shown in the references to the definition of dividend in section 115 in such cases as *Foley Securities Corporation*, *Roy J. Kinnear*, and *Loren D. Sale*, *supra*.

Since the money here involved as distributed to stockholders was in fact earned by the corporation since February 28, 1913, it is to be presumed that Congress, intending to use its taxing power to the fullest extent, intended to tax such funds. *Irwin v. Gavit*, 268 U. S. 161; *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84. In *Frank D. Darrow*, 8 B. T. A. 276, we said:

Though Congress exempted from taxation as dividends or otherwise, distributions of earnings accumulated prior to March 1, 1913, at the same time it so defined taxable dividends as to include every distribution of earnings accumulated since February 28, 1913, in whatever form the distribution might be made. The intention of Congress to tax as dividends, distributions, however made, of earnings since February 28, 1913, is evident from the broad and comprehensive language of the definition and the specific inclusion of stock dividends to the extent of such earnings. \* \* \*

*Eisner v. Macomber*, 252 U. S. 189, held stock dividends non-taxable. After March 1, 1913, "dividends declared and paid \* \* \* whether out of current earnings or profits accumulated prior to that date [not here involved] constituted income to the stockholders and not capital and were taxable as income if the Congress saw fit to impose the tax." *Helvering v. Canfield*, 291 U. S. 163. Did Congress so intend? The petitioner here is seeking immunity from tax, that is, is seeking an exemption, a matter of legislative grace. She has, therefore, the burden of showing a clear and unambiguous statutory right to such exemption from tax. *Wright v. Georgia R. R. & Banking Co.*, 216 U. S. 420; *New Colonial Ice Co. v. Helvering*, 292 U. S. 435; *White v. United States*, 305 U. S. 281. Exemptions can not rest on implication, doubt, or ambiguity; *United States v. Stewart*, 311 U. S. 60; or inference, *Pacific Co., Ltd. v. Johnson*, 285 U. S. 480.

The majority view here is seen as resting on nothing else. The most that appears to be relied on is possible ambiguity in the word "accumulation," in Section 115 of the Internal Revenue Code. Section 115, defining dividends, not only fails to provide for exemption from taxation of dividends to the extent there were pre-March 1, 1913, operating or capital deficits, but affirmatively defines dividend as being, *inter alia*, a distribution out of "earnings or profits accumulated after February 28, 1913"; and, what is even more significant, in providing exemption from tax, as to the period before March 1, 1913, carefully limited itself to providing that "any earnings or profits accumulated, or increase in value of property accrued before March 1, 1913, may be distributed exempt from tax \* \* \*." "*Inclusio unius est exclusio alterius*" never applied more clearly. The exemption desired by the petitioner is excluded. The statute, instead of showing the clear right to exemption which petitioner must show, to the contrary clearly negatives such right. It is to be noted also, in the language last quoted, the recognition of "earnings or profits accumulated \* \* \* before March 1, 1913,"—a plainly intended contrast to "earnings or profits accumulated after February 28, 1913," in the preceding subsection, 115(a). Yet the majority view, insofar as it is able to rely on section 115 at all, is that (because of general ideas of corporate profit existing only after repairment of capital and because the cited cases above-mentioned hold that post-February 28, 1913, operating losses may be re-

couped out of earnings and profits before accumulation of profits to pay taxable dividends) "there can be no accumulation of post-February 28, 1913, profits for the purpose of distributing taxable dividends, until impaired capital at March 1, 1913, has been restored." But this only amounts to the argument that on this tax question, before taxable dividends can be paid, there must be net profits from the inception of the corporation, and that though Congress defined a dividend as from accumulations after February 28, 1913, and used "accumulated" to refer to two distinct periods, before and after that date, yet the word must be held to refer to and encompass the whole corporate life so that, for present tax purposes, there is no accumulation of earnings and profits because of capital impairment in the earlier period. But the statute does not say "profit" or "net profit" or "net profit [or net accumulations] over corporate life," but only "earnings or profits accumulated after February 28, 1913." The text of the Canfield case indicates that the petitioner there made the same argument as here, for the Court says: "The argument for the stockholders stresses the word 'accumulated.' We think that the expression is made to carry too heavy a burden."

In my opinion, the language of section 115 obviously and affirmatively refutes the majority view. It subjects all of the net accumulations of earnings or profits after February 28, 1913, to taxable distribution. Under the Canfield case, where deficits apply against March 1, 1913, surplus, later lost, and not against later earnings, we see even more

than the post-March 1, 1913, net so subjected to tax. It does not carve out or except any amount equivalent to operating deficits or capital losses prior to that date. The only provision of that nature, or as to the earlier period, is as to tax-free distribution of earnings or profits as to the time before February 28, 1913. In addition to the above reasons for so believing, I note that section 115(b) also states that "for the purposes of this chapter every distribution is made \* \* \* from the most recently accumulated earnings or profits"; further that earnings or profits accumulated before March 1, 1913, may be distributed only after distribution of those accumulated after that date. It is clear that Congress had a concept of "accumulation" as being in three chronological categories, completely contrary to the majority's idea of considering the corporate life, even prior to March 1, 1913, as one continuous period of accumulation. It seems to me impossible to read section 115(a) and to conclude that "accumulated after February 28, 1913," means accumulated both before and after that time, when the word is used as to three distinct periods. Accumulation may be recent, may be back to February 28, 1913, and may be before that date. And so far as the phrase "earnings or profits" is concerned a corporation has profits, taxable profit, despite earlier deficits. Long Beach Improvement Co., 5 B. T. A. 590. There it was held that although net income of a corporation for 1920 was insufficient to wipe out a pre-existing deficit ("for several years prior to 1919") nevertheless such income was taxable to the corporation.

This can only mean that the corporation actually had "earnings or profits" for 1920 despite its previous deficit. How then can it be said that such corporation did not have "earnings or profits" within the definition of dividend in section 115? In the Long Beach case the Court disagreed with the petitioner's contention that net income was something different when applied to a corporation from "gain, net gain, profit, net profit." Thus we see that that corporation had net profit for 1920 despite earlier capital deficits. It would in that respect be immaterial whether those deficits were before or after March 1, 1913. In *Cranson v. United States*, 146 Fed. (2d) 871, Long Beach Improvement Co., *supra*, was cited and approved. It is relied on for the above conclusion in *Foley Securities Corp.*, *supra*, (one of the cases relied on by the majority here), where we said:

\* \* \* There is no doubt that the term "income" as used in the Sixteenth Amendment is broad enough to cover current corporate income even though a deficit may exist. Congress can and does impose a tax on such income. \* \* \*

In my view, not only is there within section 115 accumulation, but accumulation of "earnings or profits" after February 28, 1913, though there is capital impairment prior to that date.

In *Helvering v. Canfield*, *supra*, the Court had, as it said, no case of impairment of capital but it also said "We are dealing with a distribution of accumu-

lated profits." They referred to profits accumulated from 1917 to 1923. The Court continued:

\* \* \* When a corporation continued in business after March 1, 1913, the dividends it later declared and paid to its stockholders, whether out of current earnings or from profits accumulated prior to that date, constituted income to the stockholders, and not capital, and were taxable as income if the Congress saw fit to impose the tax. *Lynch v. Hornby*, 247 U. S. 339, 38 S. Ct. 543, 62 L. Ed. 1149. \* \* \*

I suggest that Congress has clearly, in section 115, seen fit to impose the tax, and that the majority has not demonstrated otherwise.

In the Canfield case the Court had the question whether earnings or profits actually earned in 1917-1923 should be distributed tax free, because of a theory that they should go to replace earlier losses of surplus which had existed on March 1, 1913. The Court held that the surplus, embarked in the business after March 1, 1913, had actually been lost and referring to the contention that later distributions should replace the loss, as: "immunity is sought from the taxation of an equivalent amount of profit subsequently earned," denied the immunity. The following language from the Court is highly pertinent here:

Paragraphs (a) and (b) of section 201 disclose a single purpose, and are to be construed in harmony with each other. They show that the

Congress was careful to arrange its plan so that the right to receive, free of tax, a distribution of surplus accumulated prior to March 1, 1913, should not be exercised in such a fashion as to permit profits accumulated after that date to escape taxation. To that end the Congress provided that "every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913." Then follows *the exemption which is strictly limited to a distribution of profits accumulated prior to March 1, 1913.* Nothing is said as to a restoration of those profits out of subsequent earnings if the former have been lost. (Italics supplied.)

I emphasize that the Court not only refers to the matter as an exemption, but also that it says that it is strictly limited to distribution of pre-March 1, 1913, profits. Nothing is said in section 115(a) as to restoration of lost profits or about subsequent earnings, or as to restoration of lost pre-March 1, 1913, capital therefrom. Again the Court: "But the actual course of events is not to be ignored." It seems clear that the case stands for the proposition that corporation profits actually accumulated after March 1, 1913, were by Congress subjected to tax. Just as the right to receive, free of tax, surplus accumulated before March 1, 1913," should not be exercised in such fashion as to permit profits accumulated after that date to escape taxation" so, in my view, the

general concept of capital repairment should not be so strained (here as to a period prior to February 28, 1913), as to overthrow the text and intendment of section 115, and cause exemption from tax. Exemption from tax "strictly limited" can not encompass such an end. I can not conceive why, if loss of surplus accumulated on March 1, 1913, is not in the Canfield case permitted to work such an effect, a still earlier loss of capital, prior to March 1, 1913, should be accorded a different result, and profits admittedly earned since the inception of income tax be freed from tax.

In *Hoffman v. United States*, 53 Fed. (2d) 282, the corporation had a pre-March 1, 1913, operating loss of about \$211,000, and a profit of \$132,000 from March 1, 1913, to December 31, 1913. In the course of the opinion the Court says:

\* \* \* If the profit of 1913 had been distributed in that year, we think it would have been taxable, notwithstanding there was an operating deficit prior to March 1 of that year. \* \* \*

The corporation's assets had increased in value, prior to March 1, 1913, and the opinion holds that such increase was distributable free of tax in 1917, but nowhere do I find the taxable amount, of a dividend paid in 1917, affected by the \$211,000 pre-March 1, 1913, operating loss, though other distributions and profits and losses after 1913 had to be considered in fixing the amount.

The majority finds *Chapman v. Anderson*, 11 F.

Supp. 913, in point. The petitioner on brief called this "the only case in which this case has been squarely decided." Yet there the Court was concerned only with whether an entry on corporate books writing up assets by \$274,838.97, to reflect value on March 1, 1913, was earnings or profits applicable to reduce an operating deficit of that date so as to affect taxability of distribution on stock in 1925-1926—and the Court held it was not. The present question seems not to have been presented. "The only point at issue is the interpretation to be given to the write-up of the sum of \$274,838.97." The Court did no more than assume, without analysis of the problem, that pre-March 1, 1913, operating deficits must be restored, the same as post-March 1, 1913, deficits.

In Frank D. Darrow, *supra*, we held that because there was in the Revenue Act of 1921 no provision excluding liquidating distributions from earnings or profits since February 28, 1913, from general statutory definition of dividend, they were above capital to be taxed as dividends. We said:

Again we find clearly expressed the intention of Congress to tax as a dividend every distribution of earnings accumulated since February 28, 1913, in whatever form or manner made, and in the absence of a contrary intent appearing from the Act, a liquidating distribution of such earnings would be taxable as other dividends. \* \* \*

The Darrow case is cited and approved in *McCaughn v. McCahan*, 39 Fed. (2d) 3, and various other cases to the same effect.

Thus it is seen that a definite statutory provision (such as has been in the revenue acts since 1924, as to liquidating distributions) is necessary to exclude any dividend from the broad sweep of Congressional intent and the language found in section 115(a). The majority points to no statute, except to the extent that it interprets "accumulated" in section 115(a), but relies on general ideas not related to the revenue acts since 1913.

Again, I note that the regulations, e.g., Regulations 94, Section 115, have long set forth the requirements of a dividend, and among other statements we find that a distribution of earnings or profits accumulated prior to March 1, 1913, is not a dividend; also that in determining source of a distribution, earnings or profits accumulated prior to March 1, 1913, are to be considered only "after all the earnings or profits of the taxable year and all the earnings or profits accumulated since February 28, 1913, have been distributed." Again: "A loss sustained for a year prior to the taxable year does not affect the earnings or profits of the taxable year" (with discussion of exceptions not here pertinent. No exception is made as to pre-March 1, 1913, capital impairment). These provisions of the regulations seem to me to show that dividends are there construed as not to require consideration of capital losses in the pre-March 1, 1913, period. The idea ap-

proved by the majority is not set forth in the regulations, just as it is found lacking in the statute. The repeated reenactment of the statute so construed by the regulations, gives to them the effect of law, and precludes the interpretation given by the majority. *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110. Congress, in my view, did not contemplate immunity from taxability of earnings after March 1, 1913, by deduction of capital invested, but already lost by that date. The capital as it stood at that date appears to me properly the source of later income. Income is "fruit born of capital." *United States v. Safety Car Heating & Lighting Co.*, 297 U. S. 88. The part earlier lost was not risked in the business after February 28, 1913, as was the March 1, 1913, surplus in the *Canfield* case.

Under section 113(a) (14) the stockholder may take either cost or March 1, 1913, fair market value, whichever is greater, as his basis, for determining gain, and the section provides that in determining such value due regard shall be given to value of the corporate assets. The stockholder can be taxed with gain, only above his pre-March 1, 1913, cost, and not above value on that date, if less than cost. *Goodrich v. Edwards*, 255 U. S. 527. He is, therefore, both by the statute and the constitutional principle as laid down in the *Goodrich* case, protected against pre-March 1, 1913, depreciation in value in his stock, in the computation of profit or loss, upon sale. I, therefore, discern no reason for allowing him non-taxability, with the attendant adjustment downward

of his base, when he receives a dividend, sufficient to override the plain statutory definition of dividend as distribution of post-February 28, 1913, profits. He is, in effect, not affected, in the end, by the pre-February 28, 1913, operating deficit affecting value of his stock, since he may take cost, at an earlier date, as basis, and the majority view would merely accelerate recovery of a part of his basis, deferring tax until disposition of the stock. Ground therefor, contrary to the text of section 115, does not appear. March 1, 1913, has a definite meaning for income tax purposes, and general ideas of corporate accounting are subject thereto and to the language of section 115. I am not assisted, on this question, by *Willcutts v. Milton Dairy Co.*, 275 U. S. 215, as to invested capital and excess profits. It states specifically that *Long Beach Improvement Co.*, *supra*, "is not of moment. The deductions from gross income allowed by that Title [Title 2 of the Revenue Act of 1918, as to income tax] do not refer to invested capital, surplus or undivided profits, and its provisions throw no light upon the meaning of those terms as used in Title 3 providing for an excess-profits tax."

*Lynch v. Hornby*, 247 U. S. 339, though based on the Act of 1913, and with no reference to the particular question here, is opposed to the majority view, though therein cited; for it stands for the principle that under the broad definition of income, Congress was at liberty to tax all dividends declared and paid in the ordinary course "after taking effect of the act (March 1, 1913)," even though derived

from pre-March 1, 1913, earnings, unless as later in the income tax Acts of 1916 and 1917, Congress saw fit specifically to except such pre-March 1, 1913, earnings from taxation. So here, without a statute of similar import, it is submitted that operating deficits prior to the effective date of the first income tax act have not been given tax-immunizing effect, in the face of the broad definition of dividend in section 115(a) and the Congressional intent to use its full taxing power. To point up my view, above expressed, that "accumulation" is separately applied to the post-February 28, 1913, period, *Lynch v. Hornby* itself does so; for, discussing undivided profits before declaration of a dividend, it is said:

This treatment of undivided profits applies only to profits permitted to accumulate after the taking effect of the act, since only with respect to these is a fraudulent purpose of evading the tax predictable. Corporate profits that accumulated before the act took effect stand on a different footing. \* \* \* (Emphasis supplied.)

I would not diminish earnings or profits in fact accumulated since February 28, 1913, by capital deficits prior thereto, and, therefore, I respectfully dissent.

Arnold and Opper, JJ., agree with this dissent.

Served Dec. 21, 1949.

The Tax Court of the United States  
Washington

Docket No. 5333

GRACE H. KELHAM,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated December 20, 1949, the respondent herein filed a computation of tax on February 28, 1950, and the petitioner on the same date filed an acquiescence in the respondent's computation. In accordance therewith it is

Ordered and Decided: That for the year 1940 there is an overpayment in income tax of \$59,424.62, which amount was paid after the mailing of the notice of deficiency.

Enter:

/s/ BOLON B. TURNER,  
Judge.

Entered Mar. 14, 1950.

Served Mar. 15, 1950.

In the United States Court of Appeals  
for the Ninth Circuit

T. C. Docket No. 5333

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,

vs.

GRACE H. KELHAM,  
Respondent on Review.

**PETITION FOR REVIEW**

To the Honorable Judges of the United States Court  
of Appeals for the Ninth Circuit:

The Comissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 14, 1950, "That for the year 1940 there is an overpayment in income tax of \$59,424.62" in respect of the Federal income tax liability of Grace H. Kelham, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Grace H. Kelham, is a resident of California whose mailing address is 1110 Crocker Building, San Francisco, California. Respondent's Federal income tax return for the calendar year 1940, the taxable year here involved, was filed with the Collector of Internal Revenue for the

First District of California, whose office is located in San Francisco, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

### Nature of Controversy

During the taxable year 1940 the respondent on review was the owner of 6 shares of stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 972 shares of the capital stock of said company, in respect of which shares she received during the year 1940 distributions in the amount of \$66,504.00. The respondent was also the beneficiary of a trust among the assets of which trust were voting trust certificates representing 1,340 shares of the capital stock of J. D. and A. B. Spreckels Company. As a part of her share of the distributable income of said trust for the year 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company in 1940 on said 1,340 shares, the sum of \$45,560.00. In her Federal income tax return for the year 1940 the respondent returned as taxable income only \$11,922.64 in respect of the shares of J. D. and A. B. Spreckels Company owned directly by her and only \$10,327.56 in respect of her share of distributions made to the trust. In his redetermination of the respondent's tax liability for the year 1940 the Commissioner increased the distributions returned by the respondent to their full amounts.

It was the taxpayer's contention before The Tax Court of the United States, among other things, that in determining the percentages or amounts of the distributions made by the J. D. and A. B. Spreckels Company which represented taxable dividends in the hands of the recipients thereof it is necessary to first restore out of subsequent earnings and profits the pre-March 1, 1913, accumulated operating losses, or deficits, of the predecessor of J. D. and A. B. Spreckels Company and its affiliated companies. The Commissioner contended, on the other hand, that operating deficits as of March 1, 1913 may not be restored by subsequent earnings and profits in determining the amount of earnings or profits accumulated after February 28, 1913, which would constitute taxable dividends to the recipients in whole or in part. The Tax Court of the United States disagreed with the Commissioner's determination and allowed the restoration of pre-March 1, 1913, accumulated operating losses for the purpose of determining the amount of subsequent earnings and profits available for distribution as taxable dividends.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed June 2, 1950, T.C.U.S.

The Tax Court of the United States  
Docket No. 5334

LEILA H. NEILL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (San Francisco—IRA:90D-LB) dated May 26, 1944, and as a basis of her proceeding alleges as follows:

1. Petitioner is an individual, whose mailing address is 1110 Crocker Building, San Francisco, California. The return for the period here involved was filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on May 26, 1944.

3. The taxes in controversy are income taxes for the calendar years 1938, 1939 and 1940, in the respective amounts of \$9,694.00, \$13,975.37 and \$46,595.38.

4. The determination of tax set forth in said notice of deficiency is based on the following errors:

(a) The Commissioner erred in disallowing as a deduction interest paid by petitioner during the calendar year 1938 in the amount of \$7,213.96.

(b) The Commissioner erred in disallowing as a deduction interest paid by petitioner during the calendar year 1940 in the amount of \$5,273.73.

(c) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1938 were paid out of earnings or profits to the extent of 100% thereof, and the Commissioner erred in failing to find that no portion of said distributions were paid out of earnings or profits, and in failing to allow in full petitioner's claim for refund of income taxes paid for the year 1938.

(d) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1939 were paid out of earnings or profits to the extent of 100% thereof, and the Commissioner erred in failing to find that at least 45.186% of said distributions were not paid out of earnings or profits, and in failing to allow to that extent petitioner's claim for refund of income taxes paid for the calendar year 1939.

(e) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1940 were paid out of earnings or profits to the extent of 100% thereof, and as a result of said determination increasing petitioner's income for the year 1940 by the amount of \$91,892.48, and the

Commissioner erred in failing to find that at least 79.792% of said distributions were not paid out of earnings or profits.

(f) The Commissioner erred in disallowing as a deduction expenses paid by petitioner during the calendar year 1938 in the amount of \$222.36 incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income.

5. The facts upon which petitioner relies as the basis for this proceeding are as follows:

(a) Petitioner deducted from gross income on line 14 of her Income Tax Return (Form 1040) for the calendar year 1938, interest in the total sum of \$8,717.33, which said total sum included interest in the amount of \$7,213.96 paid by petitioner to the Collector of Internal Revenue during the calendar year 1938 under the circumstances hereinafter set forth.

(b) Petitioner is one of the two daughters of Grace S. Hamilton, who died on January 23, 1937, leaving an estate subject to probate with an appraised value at the date of death of \$144,429.26. The debts of decedent and administration expenses of said estate totalled \$129,006.92. Said decedent had made transfers prior to her death of a substantial portion of her property, and the Commissioner of Internal Revenue determined that a portion of said transfers was includable in the gross estate of said decedent and subject to federal estate tax. The federal estate tax payable by the estate of said decedent, including the taxable portion of

said transfers as finally determined by said Commissioner, was the sum of \$672,809.04.

(c) Petitioner and her sister were each transferees of one-half of said transfers made by said decedent prior to her death, including the taxable portion of said transfers as finally determined by said Commissioner in determining the amount of said federal estate tax as aforesaid, and petitioner as such transferee was personally liable for the payment of said tax.

(d) The federal estate tax shown to be due by the return (Form 706) filed for said estate was \$642,119.42 and said tax became due and payable on April 23, 1938. During the calendar year 1938 petitioner and her said sister paid to the Collector of Internal Revenue the tax shown to be due by said return in equal proportions as between themselves as follows:

\$150,114.01 on July 22nd;  
\$99,981.83 on August 27th; and  
\$392,123.58 on September 29th.

(e) On September 29, 1938, petitioner and her said sister, in equal proportions as between themselves, paid to the Collector of Internal Revenue the interest due on said federal estate tax, which interest amounted to \$14,427.92. Petitioner's proportion of said interest was the sum of \$7,213.96. The Commissioner has erroneously disallowed the deduction of said interest taken by petitioner on her income tax return as aforesaid.

(f) Petitioner deducted from gross income on

line 14 of her Income Tax Return (Form 1040) for the calendar year 1940 interest in the total sum of \$8,456.97, which said total sum included interest in the amount of \$2,250.25 paid by petitioner to the Collector of Internal Revenue during the calendar year 1940 and interest in the amount of \$3,023.48 paid to the State Treasurer of the State of California during the calendar year 1940 under the circumstances hereinafter set forth.

(g) During the calendar year 1940 said Commissioner determined that there was a deficiency in federal estate tax due from the estate of said decedent in the amount of \$39,270.78 and on June 18, 1940, petitioner and her said sister paid to the Collector of Internal Revenue said deficiency together with interest in the amount of \$4,500.51 in equal proportions as between themselves. Petitioner's proportion of said interest was the sum of \$2,250.25.

(h) The Inheritance Tax Appraiser of the State of California also determined that a portion of said transfers made by said decedent prior to her death was subject to state inheritance taxes, and said taxes became due and payable on January 23, 1939. The total amount of said taxes was the sum of \$182,857.20, one-half of said sum having been assessed on account of petitioner's interest in said estate and in said transfers, and in certain insurance moneys received by reason of the death of said decedent. On January 20, 1939, petitioner and her said sister, in equal proportions as between themselves, paid to the State Treasurer of the State

of California on account of said state inheritance taxes the sum of \$131,026.00. On September 23, 1940, petitioner and her said sister, in equal proportions as between themselves, paid to the said State Treasurer of the State of California the balance of said state inheritance taxes in the amount of \$51,831.20 together with interest thereon in the amount of \$6,046.97. Petitioner's proportion of said interest was the sum of \$3,023.48.

(i) The Commissioner has erroneously disallowed the deduction of said interest in the amount of \$2,250.25 paid to the Collector of Internal Revenue and said interest in the amount of \$3,023.48 paid to said State Treasurer, taken by petitioner on her income tax return as aforesaid.

(j) From January 1, 1938, to and including October 5, 1938, petitioner owned directly 978 shares of the capital stock of J. D. and A. B. Spreckels Company. During the remainder of 1938 and during the years 1939 and 1940, petitioner owned directly 6 shares of the capital stock of said corporation. On October 6, 1938, petitioner deposited with voting trustees 972 shares of the capital stock of said corporation, and during the remainder of 1938 and during the years 1939 and 1940 petitioner was the owner of voting trust certificates representing 972 shares of the capital stock of said corporation. During the years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Grace S. Hamilton Trust, Crocker First National Bank of San Francisco, et al.,

trustees (except that during a portion of 1938 American Trust Company of San Francisco, et al., were trustees) and as such beneficiary was entitled to receive one-half of the income of said trust during said years. Included in the assets of said trust during said years were voting trust certificates representing 1340 shares of the capital stock of J. D. and A. B. Spreckels Company.

(k) During the calendar year 1938 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$42.50 per share. Petitioner received from said distributions the total sum of \$70,040.00 representing a distribution of \$42.50 per share on 1648 shares, of which 670 shares represented petitioner's one-half interest in the said Grace S. Hamilton Trust and the remainder represented shares owned directly, or as voting trust certificates. Petitioner reported on her Income Tax Return (Form 1040) for the calendar year 1938 said sum of \$70,040.00 as follows: \$22,005.00 (included in the sum of \$30,002.21) on line 2 as dividends received; \$19,560.00 (included in the sum of \$30,840.96) on line 7 as income distributed by the voting trustees; and \$28,475.00 on line 7 as income from said Grace S. Hamilton Trust.

(l) On March 28, 1941, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1938 in the amount of \$6,703.76. Said claim for refund was based on the ground that all said cash distributions in the amount of

\$70,040.00 received by petitioner during the calendar year 1938 from J. D. and A. B. Spreckels Company, either directly or indirectly, constituted non-taxable distributions. The Commissioner has failed to allow any portion of said claim for refund.

(m) During the calendar year 1939 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$55.00 per share. Petitioner reported the receipt of said distribution on her income tax return (Form 1040) for the year 1939 as follows: On line 2 (included in the sum of \$8,073.50) as dividends received directly on 6 shares, the amount of \$330.00; on line 7, as income distributed by the voting trustees, the sum of \$53,362.64 representing dividends received on 972 shares in the amount of \$53,460.00 less expenses in the amount of \$97.36; and on line 7, as income received from said Grace S. Hamilton Trust (included in the sum of \$38,589.54) the amount of \$36,850.00 representing dividends on 670 shares.

(n) On April 4, 1941, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1939 in the amount of \$14,379.85. Said claim for refund was based on the ground that all said cash distributions in the amount of \$90,640.00 received by petitioner during the calendar year 1939 from J. D. and A. B. Spreckels Company, either directly or indirectly, constituted non-taxable distributions. The Commissioner has failed to allow any portion of said claim for refund.

(o) During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its

stockholders in the amount of \$68.00 per share. Petitioner received, either directly or indirectly, from said distributions the sum of \$112,064.00. On her Income Tax Return (Form 1040) for the calendar year 1940, petitioner excluded 82% of said distributions as non-taxable distributions and reported the remaining 18% thereof as follows: On line 2 (included in the sum of \$1,243.74) as dividends received directly on 6 shares the amount of \$73.44; on line 7, as income distributed by the voting trustees, the sum of \$11,799.92 representing dividends received on 972 shares in the amount of \$11,897.28 less expenses in the amount of \$97.36; and on line 7, as income received from said Grace S. Hamilton Trust (included in the sum of \$10,327.56) the amount of \$8,200.80 representing dividends on 670 shares.

(p) The Commissioner has erroneously increased petitioner's dividend income reported on line 2 of her said return by the amount of \$334.56, and has erroneously increased petitioner's fiduciary income reported on line 7 of her return by the amount of \$91,557.92. The total of said adjustments in the amount of \$91,892.48 represents 82% of the distributions received by petitioner, either directly or indirectly, from J. D. and A. B. Spreckels Company during the calendar year 1940 and which petitioner did not report on the ground that such distributions constituted non-taxable distributions as aforesaid.

(q) Petitioner alleges that no part of the cash distributions in the sum of \$70,040.00 received by

petitioner, either directly or indirectly, during the calendar year 1938 from said J. D. and A. B. Spreckels Company was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of earnings or profits for the calendar year 1938, and that said cash distributions were not subject to income tax in the hands of and were not taxable to petitioner.

(r) Petitioner alleges that only a portion of said cash distributions in the sum of \$90,640.00 received by petitioner, either directly or indirectly, during the calendar year 1939 from said J. D. and A. B. Spreckels Company, to wit: the sum of not more than \$49,683.41 was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1939, and that the balance of said sum of \$90,640.00, to wit: an amount not less than the sum of \$40,956.59 was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1939, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(s) Petitioner alleges that only a portion of said cash distributions in the sum of \$112,064.00 received by petitioner, either directly or indirectly, during the calendar year 1940 from said J. D. and A. B. Spreckels Company, to wit: the sum of not more than \$22,645.89 was paid out of the earnings or profits of said corporation accumulated after

February 28, 1913, or out of its earnings or profits for the calendar year 1940, and that the balance of said sum of \$112,064.00, to wit: an amount not less than the sum of \$89,418.11, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1940, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(t) Petitioner is informed and believes, and therefore alleges, that on January 1, 1938, J. D. and A. B. Spreckels Company had no earnings or profits accumulated since March 1, 1913, that its earnings or profits for the calendar years 1938, 1939 and 1940 did not exceed the amounts set forth below, and that the distributions to its stockholders made by said corporation during said years were as follows:

Year	Earnings or Profits	Distributions
1938	(Loss) \$1,313,516.91	850,000.00
1939	602,954.70	1,100,000.00
1940	274,827.56	1,360,000.00

(u) The basis to petitioner on January 1, 1938, for income tax purposes, of each share of the capital stock of J. D. and A. B. Spreckels Company, and of each share of said stock represented by voting trust certificates, held by said petitioner during the calendar years 1938, 1939 and 1940 was greater than the aggregate cash distributions made by said corporation during said three year period

on each of said shares. The basis to said Grace S. Hamilton Trust on January 1, 1938, for income tax purposes, of each share of said stock represented by voting trust certificates held by said trust during the calendar years 1938, 1939 and 1940 was greater than the aggregate cash distributions made by said corporation during said three year period on each of said shares.

(v) During the calendar year 1938 petitioner paid to Crocker First National Bank of San Francisco, as her proportion of the fee for acting as the agent of said voting trustees, the sum of \$97.36, and petitioner paid to a bookkeeper for keeping accounts of her financial affairs during the calendar year 1938 the sum of \$125.00.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that petitioner is entitled to a refund of income taxes paid for the calendar year 1938 of at least \$6,703.76; that petitioner is entitled to a refund of income taxes paid for the calendar year 1939 of at least \$13,975.37; and that the deficiency in income tax for the calendar year 1940 does not exceed \$166.81.

/s/ LEON DE FREMERY,  
Counsel for Petitioner.

State of California,  
City and County of San Francisco—ss.

Leila H. Neill, being duly sworn, says:

That she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, is familiar with the statements contained therein, and that the statements contained

therein are true, except those stated to be upon information and belief, and those she believes to be true.

/s/ LEILA H. NEILL.

Subscribed and sworn to before me this 7th day of June, 1944.

[Seal] /s/ W. W. HEALEY,  
Notary Public in and for the City and County of  
San Francisco, State of California.

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### EXHIBIT A

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street  
San Francisco 26, California

Office of  
Internal Revenue Agent in Charge  
San Francisco Division  
IRA:90-D-LB  
(C:TS:PD  
SF:WGW)

May 26, 1944

Mrs. Leila H. Neill  
1110 Crocker Building  
San Francisco, California

Dear Mrs. Neill:

You are advised that the determination of your income tax liability for the taxable years 1938, 1939 and 1940 discloses a deficiency of \$49,994.48 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco 5, California, for the attention of—Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

JOSEPH D. NUNAN, JR.,  
Commissioner.

By F. M. HARLESS,  
Internal Revenue Agent  
in Charge.

HJB

Enclosures:

Statement

Form of Waiver.

## Statement

San Francisco  
 IRA: 90-D-LB  
 (C:TS:PD  
 SF:WGW)

Mrs. Leila H. Neill  
 1110 Crocker Building  
 San Francisco, California

Tax Liability for the Taxable Years Ended December 31, 1938,  
 December 31, 1939, and December 31, 1940

Year	Income Tax		
	Liability	Assessed	Deficiency
1938.....	\$ 9,694.00	\$ 6,703.76	\$ 2,990.24
1939.....	14,621.90	14,379.85	242.05
1940.....	46,874.05	111.86	46,762.19
 Totals .....	 \$71,189.95	 \$21,195.47	 \$49,994.48

In making this determination of your income tax liability, careful consideration has been given to your protests dated May 28, 1941, and March 10, 1943, and to the statements made at the conferences held on February 2, 1942, May 20, 1942, September 11, 1942, April 30, 1943, February 15, 1944, and February 23, 1944. Consideration has also been given your claims for refund filed on March 29, 1941, for \$6,703.76 covering the year 1938; and April 5, 1941, for \$14,379.85 covering the year 1939.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein the issues set forth in your claims for 1938 and 1939 tax should be made a part of the petition to be considered by the Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with existing internal revenue laws.

A copy of this letter and statement has been mailed to your representative, Mr. Leon de Fremery, 1110 Crocker Building, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

You contend that your share of distributions by J. D. and A. B. Spreckels Company, a corporation, in which you owned stock directly and in which trusts, of which you were a beneficiary, owned stock is not taxable as a dividend in the year 1938, and that your share for the years 1939 and 1940 is taxable in part only. In the years 1938 and 1939 you reported the full distributions as taxable income. In the year 1940, you reported only 18 per cent as taxable. It is held that the distributions are out of earnings and profits accumulated after February 28, 1913, and are taxable as dividends in their entirety.

## Adjustments to Net Income

Year: 1938

Net income as disclosed by return.....	\$41,874.49
Unallowable deductions and additional income:	
(a) Interest .....	\$7,213.96
(b) Other expense .....	222.36
	7,436.32
Net income adjusted .....	\$39,310.81

## Explanation of Adjustments

(a) You claimed on your income tax return for 1938, a deduction of \$7,213.96 for interest upon a deficiency in estate tax in the Estate of Grace S. Hamilton, Deceased. It is held that said amount was not paid on your indebtedness and is not deductible. See section 23(b) of the Revenue Act of 1938.

(b) The deduction of \$222.36 for fees and other expenses shown on line 18 of your return is disallowed since they do not constitute ordinary and necessary business expense and no other basis for the deduction has been established.

## Computation of Alternative Tax

Year: 1938

(Section 117 (c)—Revenue Act of 1938)

Net income .....	\$49,310.81
Plus: Net long-term capital loss .....	18,007.86
Ordinary net income .....	\$67,318.67
Less: Personal exemption .....	\$2,500.00
Credit for dependents .....	566.87
	3,066.67
Balance (surtax net income).....	\$64,252.00
Less: Earned income credit .....	300.00
Net income subject to normal tax.....	\$63,952.00
Normal tax at 4 per cent on \$63,952.00.....	\$ 2,558.08
Surtax on \$64,252.00.....	12,538.28
Partial tax .....	\$15,096.36
Minus: 30 per cent of net long-term loss.....	5,402.36
Alternative tax .....	\$ 9,694.00

## Computation of Tax

Year: 1938

Net income adjusted .....	\$49,310.81
Less: Personal exemption .....	\$2,500.00
Credit for dependents .....	566.67
	3,066.67
Balancee (surtax net income) .....	\$46,244.14
Less: Earned income credit .....	300.00
Net income subject to normal tax.....	\$45,944.14
Normal tax at 4 per cent on \$45,944.14.....	\$ 1,837.77
Surtax on \$46,244.14.....	6,685.92
Total tax (ordinary rates) .....	\$ 8,523.69
Alternative tax .....	\$ 9,694.00
Correct income tax liability .....	\$ 9,694.00
Income tax assessed: Original, account No. 201571—	
First California District .....	6,703.76
Deficiency of income tax .....	\$ 2,990.24

## Adjustments to Net Income

Year: 1939

Net income as disclosed by return.....	\$50,888.44
Unallowable deductions and additional income:	
(a) Rental income .....	440.08
Net income adjusted .....	\$51,328.52

## Explanation of Adjustments

(a) Rentals of \$452.38 at item 8 of your return represented a net balancee after deducting \$440.08 for depreciation on furniture in a rented apartment. Such deduction was in error since furniture had been removed from the apartment in 1939 and no deductible depreciation was sustained.

Computation of Alternative Tax  
Year: 1939

## (Section 117 (c)—Internal Revenue Code)

Net income .....	\$51,328.52
Plus: Net long-term capital loss .....	38,472.86
Ordinary net income .....	\$89,801.38
Less: Personal exemption .....	\$2,500.00
Credit for dependents .....	800.00      3,300.00
Balance (surtax net income) .....	\$86,501.38
Less: Earned income credit .....	300.00
Net income subject to normal tax.....	\$86,201.38
Normal tax at 4 per cent on \$86,201.38.....	\$ 3,448.06
Surtax on      \$86,501.38.....	22,715.70
Partial tax .....	\$26,163.76
Minus: 30 per cent of net long-term loss .....	11,541.86
Alternative tax .....	\$14,621.90

Computation of Tax  
Year: 1939

Net income adjusted .....	\$51,328.52
Less: Personal exemption .....	\$2,500.00
Credit for dependents .....	800.00      3,300.00
Balance (surtax net income) .....	\$48,028.52
Less: Earned income credit .....	300.00
Net income subject to normal tax .....	\$47,728.52
Normal tax at 4 per cent on \$47,728.52.....	\$ 1,909.14
Surtax on      \$48,028.52.....	7,167.70
Total tax (ordinary rates).....	\$ 9,076.84
Alternative tax .....	\$14,621.90
Correct income tax liability.....	\$14,621.90
Income tax assessed: Original, account No. 200686—	
First California District .....	14,379.85
Deficiency of income tax.....	\$ 242.05

## Adjustments to Net Income

Year: 1940

Net income as disclosed by return.....	\$ 5,642.32
Unallowable deductions and additional income:	
(a) Dividends .....	\$ 334.56
(b) Fiduciary income .....	91,566.97
(c) Interest disallowed .....	5,273.73
	97,175.26
Net income adjusted .....	\$102,817.58

## Explanation of Adjustments

(a) Dividends of \$1,243.74 shown on your return included only \$73.44 out of total dividends of \$408.00 received directly from the J. D. and A. B. Spreckels Co. The balance of \$334.56 was omitted by you on the basis of your contention that 82 per cent of the distribution was nontaxable. The entire amount is considered taxable and your net income is increased accordingly.

(b) Fiduciary income reportable by you is revised as follows:

From Crocker First National Bank, agent for Voting Trustees of J. D. and A. B. Spreckels Co., as per your return.....	\$11,799.92
Add: 82 per cent of \$66,096.00, portion of dividends from J. D. and A. B. Spreckels Co. omitted from your return.....	54,198.72
	\$ 65,998.64
From Trust u/d Grace S. Hamilton, as shown on your return .....	\$10,327.56
Add: 82 per cent of \$45,560.00, portion of dividends from J. D. and A. B. Spreckels Co. omitted from your return.....	37,359.20
Trustee's expense allocable to exempt interest under section 24(a)(5), Internal Revenue Code .....	9.05
Your share of trust income as revised.....	47,695.81
Total fiduciary income as revised.....	\$113,694.45
Fiduciary income as reported on return.....	22,127.48
Increase in fiduciary income.....	\$ 91,566.97

(c) You claimed on your income tax return for 1940 deductions for interest upon deficiencies in federal estate tax and state inheritance tax, in the amounts of \$2,250.25 and \$3,023.48, respectively, said amounts relating to the estate of Grace S. Hamilton, Deceased. It is held that the above-mentioned amounts aggregating \$5,273.73 were not paid on your indebtedness and are not deductible. See Section 23(b) of the Internal Revenue Code.

## Computation of Alternative Tax

Year: 1940

## (Section 117 (c)—Internal Revenue Code)

Net income .....	\$102,817.58
Plus: Net long-term capital loss .....	5,730.83
Ordinary net income .....	\$108,548.41
Less: Personal exemption .....	\$2,000.00
Credit for dependents .....	800.00
	2,800.00
Balance (surtax net income) .....	\$105,748.41
Less: Earned income credit .....	300.00
Net income subject to normal tax .....	\$105,448.41
Normal tax at 4 per cent on \$105,448.41.....	\$ 4,217.94
Surtax on \$105,748.41.....	40,114.08
Partial tax .....	\$ 44,332.02
Minus: 30 per cent of net long-term loss.....	1,719.25
Alternative tax .....	\$ 42,612.77

## Computation of Tax

Year: 1940

Net income adjusted .....	\$102,817.58
Less: Personal exemption .....	\$2,000.00
Credit for dependents .....	800.00
	2,800.00
Balance (surtax net income) .....	\$100,017.58
Less: Earned income credit .....	300.00
Net income subject to normal tax.....	\$ 99,717.58
Normal tax at 4 per cent on \$ 99,717.58.....	\$ 3,988.70
Surtax on \$100,017.58.....	36,790.20
Total tax (ordinary rates) .....	\$ 40,778.90
Alternative tax .....	\$ 42,612.77
Add: Defense tax 10 per cent .....	4,261.28
Correct income tax liability .....	\$ 46,874.05
Income tax assessed: Original, account No. 855968—	
First California District .....	111.86
Deficiency of income tax .....	\$ 46,762.19

Received and Filed June 12, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5334

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits that the taxes in controversy are income taxes for the calendar years 1938, 1939 and 1940; denies all other allegations contained in paragraph 3 of the petition.
4. (a) to (f), inclusive. Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 and subparagraphs (a) to (f), inclusive, thereunder of the petition.
5. (a) Admits that the petitioner deducted from gross income on line 14 of her income tax return (Form 1040) for the calendar year 1938, interest in the total sum of \$8,717.33; for lack of information and belief, denies all other allegations

contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that petitioner is one of the daughters of Grace S. Hamilton, who died during 1937, leaving an estate subject to probate; for lack of information and belief, denies all other allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c), (d) and (e). For lack of information and belief, denies all allegations contained in subparagraphs (c), (d) and (e) of paragraph 5 of the petition.

(f) Admits that petitioner deducted from gross income on line 14 of her income tax return (Form 1040) for the calendar year 1940 interest in the total sum of \$8,456.97; for lack of information and belief, denies all other allegations contained in subparagraph (f) of paragraph 5 of the petition.

(g) Admits that during the calendar year 1940 said Commissioner determined that there was a deficiency in Federal estate tax due from the estate of said decedent; for lack of information and belief, denies all other allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) For lack of information and belief, denies all allegations contained in subparagraph (h) of paragraph 5 of the petition.

(i) Denies the allegations contained in subparagraph (i) of paragraph 5 of the petition.

(j) Admits that during 1938 petitioner owned shares of capital stock of J. D. and A. B. Spreckels

Company; admits that during 1938, 1939 and 1940 petitioner was the owner of trust certificates representing shares of the capital stock of said corporation; admits that during the years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Grace S. Hamilton Trust, Crocker First National Bank of San Francisco, et al., Trustees, and as such beneficiary was entitled to receive income of said trust during said years; admits that included in the assets of said trust during said years were trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; for lack of information and belief, denies all other allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Admits that during the calendar year 1938 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that petitioner received certain of said distributions; for lack of information and belief, denies all other allegations contained in subparagraph (k) of paragraph 5 of the petition.

(1) Admits that on March 28, 1941, petitioner filed a claim for refund (Form 843) of income taxes for the calendar year 1938 in the amount of \$6,703.76; admits that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief, denies all other allegations contained in subparagraph (1) of paragraph 5 of the petition.

(m) Admits that during the calendar year 1939

J. D. and A. B. Spreckels Company made distributions to its stockholders; for lack of information and belief, denies all other allegations contained in subparagraph (m) of paragraph 5 of the petition.

(n) Admits that on April 4, 1941, petitioner filed a claim for refund (Form 843) of income taxes for the calendar year 1939 in the amount of \$14,379.85; admits that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief, denies all other allegations contained in subparagraph (n) of paragraph 5 of the petition.

(o) Admits that during the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that petitioner received certain of said distributions and that on her income tax return (Form 1040) for the calendar year 1940 she excluded portions of said distributions on the theory that such portions were non-taxable; for lack of information and belief, denies all other allegations contained in subparagraph (o) of paragraph 5 of the petition.

(p) Admits that the Commissioner has increased petitioner's dividend income reported on line 2 of her said return by the amount of \$34.56, and has increased petitioner's fiduciary income reported on line 7 of her return by approximately \$91,557.92, but denies that said increases were made erroneously; for lack of information and belief, denies all other allegations contained in subparagraph (p) of paragraph 5 of the petition.

(q) to (t), inclusive. Denies the allegations contained in subparagraphs (q) to (t), inclusive, of paragraph 5 of the petition.

(u) and (v) For lack of information and belief, denies all allegations contained in subparagraphs (u) and (v) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel,

T. M. MATHER,  
ARTHUR L. MURRAY,  
Special Attorneys,  
Bureau of Internal Revenue.

Received and filed July 24, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5334

### SUPPLEMENTARY STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled case, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. It is agreed that during the calendar year 1938 petitioner paid the sum of \$7,213.96 as interest and that said sum is allowable in full as a deduction in computing petitioner's taxable income for said year.
2. It is agreed that during the calendar year 1940 petitioner paid the sum of \$5,273.73 as interest and that said sum is allowable in full as a deduction in computing petitioner's taxable income for said year.
3. It is agreed that during the calendar year 1938 petitioner paid the sum of \$222.36 incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income and that said sum is allowable in full as a deduction in computing petitioner's taxable income for said year.

4. From January 1, 1938, to and including October 5, 1938, petitioner owned directly 978 shares of the capital stock of J. D. and A. B. Spreckels Company issued to and standing in her name. During the remainder of 1938 and during the entire calendar years 1939 and 1940 petitioner owned directly 6 shares of the capital stock of said company standing in her own name. On October 6, 1938, petitioner deposited with voting trustees 972 shares of the capital stock of said company and during the remainder of 1938 and during the entire calendar years 1939 and 1940 petitioner was the owner of voting trust certificates representing 972 shares of the capital stock of said company. Petitioner received from said company distributions on said shares in the following amounts:

Schedule A

Year	From Shares Standing in Her Own Name	From		Total
		Shares Covered by Said Voting Trust	Certificates	
1/ 1/38 to 12/15/38.....	\$22,050.00		\$ 7,290.00	\$29,340.00
12/22/38 .....	75.00		12,150.00	12,225.00
 Total 1938 .....	\$22,125.00		\$19,440.00	\$41,565.00
1939 .....	330.00		53,460.00	53,790.00
1940 .....	408.00		66,096.00	66,504.00

At all times during the calendar years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Grace S. Hamilton Trust, Crocker First National Bank of San Francisco, et al., Trustees, and as such beneficiary was entitled to receive one-half of the income of said trust for said years. Included in the assets of said trust for said

years were voting trust certificates representing 1,340 shares of the capital stock of J. D. and A. B. Spreckels Company. The distributions received by the trustees from said company were, under the terms of the trust, after deducting certain prior charges and expenses of the trust, currently distributable to the beneficiary. During said years the trustees made distributions as required by the terms of the trust and petitioner received from the trustees as petitioner's net share of said distributions of J. D. and A. B. Spreckels Company on said 1,340 shares the following amounts:

## Schedule B

Year	Net Distribution by Trustees	J. D. and A. B. Spreckels Company Dividends	Net Bal. of Other Items
1/1/38 to 12/15/38		\$20,100.00	
12/22/38 .....		8,375.00	
Total 1938 .....	\$28,627.13	\$28,475.00	\$ 152.13
1939 .....	\$38,589.54	\$36,850.00	\$1,739.54
1940 .....	\$47,695.81	\$45,560.00	\$2,135.81

The parties are agreed that the portions of the dividends of J. D. and A. B. Spreckels Company for the years 1938, 1939 and 1940 which this Court determines in the case of Grace H. Kelham, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 5333, have been paid out of capital will, in the case of this petitioner, represent: (a) The portions of the respective amounts listed in the "Total" column of Schedule A which will be eliminated from the petitioner's taxable income for the years 1938, 1939 and 1940; and (b) the portions of the respective amounts listed in the

column entitled "J. D. and A. B. Spreckels Company Dividends" of Schedule B which are to be subtracted from the respective amounts listed in the column entitled "Net Distribution by Trustees" of Schedule B in determining petitioner's taxable income for the years 1938, 1939 and 1940.

Dated this 31st day of October, 1947.

/s/ LEON de FREMERY,  
Attorney for Petitioner.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

Filed at hearing Nov. 3, 1947, T.C.U.S.

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The Tax Court of the United States,  
Washington  
Docket No. 5334

LEILA H. NEILL,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated December 20, 1949, the respondent herein filed a computation of tax on February 28, 1950, and the petitioner on the same date

filed an acquiescence in the respondent's computation. In accordance therewith it is

Ordered and Decided: That for the year 1938 there is an overpayment in income tax of \$4,058.66, which amount was paid after the mailing of the notice of deficiency;

That for the 1939 there is an over-payment in income tax of \$14,287.93, a portion of which amount was paid within two years before the filing of claim for refund and the remainder was paid after the mailing of the notice of deficiency;

That for the year 1940 there is an over-payment in income tax of \$57,429.30, which amount was paid after the mailing of the notice of deficiency.

Enter:

/s/ BOLON B. TURNER,  
Judge.

Entered Mar. 14, 1950.

Served Mar. 15, 1950.

In the United States Court of Appeals  
For the Ninth Circuit  
T. C. Docket No. 5334

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,  
vs.  
LEILA H. NEILL,  
Respondent on Review.

**PETITION FOR REVIEW**

To the Honorable Judges of the United States  
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby  
petitions the United States Court of Appeals for  
the Ninth Circuit to review the decision entered  
by the Tax Court of the United States on March  
14, 1950, that there are overpayments in income  
taxes for the years 1939 and 1940 in the respec-  
tive amounts of \$14,287.93 and \$57,429.30 in re-  
spect of the Federal income tax liability of Leila  
H. Neill, the above-named respondent on review.  
This petition for review is filed pursuant to the  
provisions of Sections 1141 and 1142 of the In-  
ternal Revenue Code.

The respondent on review, Leila H. Neill, is a  
resident of California whose mailing address is  
1110 Crocker Building, San Francisco, California.  
Respondent's Federal income tax returns for the  
calendar years 1939 and 1940, the taxable years  
here involved, were filed with the Collector of In-

ternal Revenue for the First District of California, whose office is located in San Francisco, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

### Nature of Controversy

From January 1, 1938, to and including October 5, 1938, the respondent on review was the owner of 978 shares of stock of J. D. and A. B. Spreckels Company. During the remainder of 1938 and during the years 1939 and 1940 the respondent on review owned directly 6 shares of the capital stock of said company and voting trust certificates representing 972 shares of the capital stock of said company. During the years 1938, 1939 and 1940 respondent received distributions from the J. D. and A. B. Spreckels Company in respect of said shares and voting trust certificates the respective aggregate sums of \$41,565.00, \$53,790.00 and \$66,504.00. The respondent was also the beneficiary of a trust among the assets of which trust were voting trust certificates representing 1,340 shares of the capital stock of J. D. and A. B. Spreckels Company. As a part of her share of the distributable income of said trust for the years 1938, 1939 and 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company during those years on said 1,340 shares, the respective sums of \$28,475.00, \$36,850.00 and \$45,560.00. In her Federal income tax returns for the years 1939 and

1940, the respondent returned as taxable income the amounts so received in 1939 but only \$11,799.92 in 1940 in respect of the voting trust certificates of J. D. and A. B. Spreckels Company owned directly by her and only \$10,327.56 in respect of her share of distributions made to the trust. All of the distributions received by the respondent in 1938 were reported as taxable income in her 1938 return. In his redetermination of the respondent's tax liability for the year 1940 the Commissioner increased the distributions returned by the respondent to their full amounts. There is now no dispute in respect of the year 1938.

In was the taxpayer's contention before the Tax Court of the United States, among other things, that in determining the percentages or amounts of the distributions made by the J. D. and A. B. Spreckels Company which represented taxable dividends in the hands of the recipients thereof it is necessary to first restore out of subsequent earnings and profits the pre-March 1, 1913, accumulated operating losses, or deficit, of the predecessor of J. D. and A. B. Spreckels Company and its affiliated companies. The Commissioner contended, on the other hand, that operating deficits as of March 1, 1913, may not be restored by subsequent earnings and profits in determining the amount of earnings or profits accumulated after February 28, 1913, which would constitute taxable dividends to the recipients in whole or in part. The Tax Court of the United States disagreed with the Commission-

er's determination and allowed the restoration of pre-March 1, 1913, accumulated operating losses for the purpose of determining the amount of subsequent earnings and profits available for distribution as taxable dividends, as a result of which allowances the overpayments of tax for the years 1939 and 1940 partly resulted.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed June 2, 1950. T.C.U.S.

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The Tax Court of the United States  
Docket No. 5495

ELLIS M. MOORE,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (San Francisco—IRA:90D-LB) dated

May 26, 1944, and as a basis of her proceeding alleges as follows:

1. Petitioner is an individual, whose mailing address is 1110 Crocker Building, San Francisco, California. The returns for the periods here involved were filed with the Collector for the First District of California.
2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on May 26, 1944.
3. The taxes in controversy are income taxes for the calendar years 1937, 1938, 1939 and 1940 and in the following amounts:

Year	Deficiency Asserted	Overpayment Claimed	Amount in Controversy
1937.....	\$ 6,989.38	\$10,436.63	\$17,426.01
1938.....	3,274.99	5,723.26	8,998.25
1939.....	2,744.62	7,324.66	10,069.28
1940.....	23,499.16	None	23,415.80

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in including in petitioner's income subject to tax for the calendar years 1937, 1938 and for the period January 1 to August 31, 1939, one-half of her husband's income from a professional partnership, of which he was a member, and in failing to find that no portion of said income was community income and taxable to petitioner.

(b) The Commissioner erred in determining

that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1937 were paid out of earnings or profits to the extent of 100% thereof, and the Commissioner erred in failing to find that at least 28.522% of said distributions were not paid out of earnings or profits, and in failing to allow to that extent petitioner's claim for refund of income taxes paid for the calendar year 1937.

(c) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1938 were paid out of earnings or profits to the extent of 100% thereof, and that the Commissioner erred in failing to find that no portion of said distributions were paid out of earnings or profits, and in failing to allow in full petitioner's claim for refund of income taxes paid for the calendar year 1938.

(d) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1939 were paid out of earnings or profits to the extent of 100% thereof, and the Commissioner erred in failing to find that at least 45.186% of said distributions were not paid out of earnings or profits, and in failing to allow to that extent petitioner's claim for refund of income taxes paid for the calendar year 1939.

(e) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreck-

els Company to its stockholders during the calendar year 1940 were paid out of earnings or profits to the extent of 100% thereof, and as a result of said determination increasing petitioner's income for the year 1940 by the amount of \$57,932.99, and the Commissioner erred in failing to find that at least 79.792% of said distributions were not paid out of earnings or profits.

(f) The Commissioner erred in failing to allow as a deduction expenses incurred in the amount of \$1,200 during each of the years 1937, 1938, 1939 and 1940 for the production or collection of income or for the management, conservation or maintenance of property held for the production of income.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner married Dr. E. Clarence Moore of Los Angeles, California, on October 20, 1936. Prior to their marriage and during the years here involved petitioner's husband was a practicing physician and derived his professional income from a partnership, of which he was a member, known as the Moore-White Clinic.

(b) Prior to their marriage petitioner and her said husband entered into an oral agreement, wherein it was provided, amongst other things, that all fees, salaries and other income earned or received after marriage for personal services or otherwise by either of them should be received as and be the separate property of the party earning or receiving such fees or salaries or other income. Said

oral agreement was reduced to writing on August 31, 1939.

(c) The Commissioner has erroneously added to petitioner's income for the calendar year 1937 the sum of \$13,078.99 alleged to be petitioner's community share of her said husband's partnership income.

(d) The Commissioner has erroneously added to petitioner's income for the calendar year 1938 the sum of \$11,571.79 alleged to be petitioner's community share of her said husband's partnership income.

(e) The Commissioner has erroneously added to petitioner's income for the calendar year 1939 the sum of \$7,381.38 alleged to be petitioner's community share of her said husband's partnership income for the period January 1 to August 31, 1939.

(f) During the calendar years 1937, 1938, 1939 and 1940 petitioner owned directly 2 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 498 shares of the capital stock of said corporation. During the years 1937, 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Claus Spreckels Trust, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive 26/32nds of the income of said trust during the calendar year 1937 and for the period January 1 to and including September 26, 1938, and was entitled to receive 23/32nds of the income of said trust for the period September 27 to December 31, 1938, and during the calendar years 1939 and 1940.

Included in the assets of said trust during each of said years were voting trust certificates representing 752 shares of the capital stock of J. D. and A. B. Spreckels Company.

(g) During the calendar year 1937 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$75.00 a share. With respect to petitioner's ownership of shares of stock and voting trust certificates as aforesaid, petitioner reported the receipt of said distributions on her income tax return (Form 1040) for the calendar year 1937 as follows: On line 2 (included in the sum of \$3,131.33) as dividends received directly on 2 shares, the sum of \$150.00; and on line 7, as income distributed by the voting trustees, the sum of \$37,291.17 representing dividends received on 498 shares in the amount of \$37,350.00 less expenses in the amount of \$58.83. Petitioner also reported on line 7 of said return, as income received from said Claus Spreckels Trust, the amount of \$45,207.43, which amount, due to the deduction of expenses, is somewhat less than petitioner's fractional interest in the distributions received from said J. D. and A. B. Spreckels Company by said trust. Petitioner filed said income tax return for the calendar year 1937 on March 15, 1938.

(h) On March 14, 1941, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1937 in the amount of \$20,546.60. Said claim for refund was based on the ground that no portion of said cash distributions in the total amount of \$82,648.60 received by petitioner during

the calendar year 1937 from J. D. and A. B. Spreckels Company, either directly or indirectly, was paid out of the earnings or profits of said corporation but that all said distributions were paid out of capital, and were not subject to income tax. The Commissioner has failed to allow any portion of said claim for refund.

(i) During the period January 1 to and including September 26, 1938, J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$22.50 a share. During the period September 27 to and including December 31, 1938, J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$20.00 a share. With respect to petitioner's ownership of shares of stock and voting trust certificates as aforesaid, petitioner reported the receipt of said distributions on her income tax return (Form 1040) for the calendar year 1938 as follows: On line 2 (included in the sum of \$1,481.51) as dividends received directly on 2 shares the sum of \$85.00; and on line 7, as income distributed by the voting trustees, the sum of \$21,115.12, representing dividends received on 498 shares in the amount of \$21,165.00, less expenses in the amount of \$49.88. Petitioner also reported on line 7 of said return, as income received from said Claus Spreckels Trust, the amount of \$24,435.16, which amount, due to the deduction of expenses, is somewhat less than petitioner's fractional interest in the distributions received from said J. D. and A. B. Spreckels Company by said

trust. Petitioner filed said income tax return for the calendar year 1938 on March 15, 1939.

(j) On February 28, 1942, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1938 in the amount of \$5,723.26. Said claim for refund was based on the ground that no portion of said cash distributions in the total amount of \$45,635.28 received by petitioner during the calendar year 1938 from J. D. and A. B. Spreckels Company, either directly or indirectly, was paid out of the earnings or profits of J. D. and A. B. Spreckels Company for the taxable year 1938, nor out of the earnings or profits of said corporation accumulated after February 28, 1913, and that said distributions were not subject to income tax. The Commissioner has failed to allow any portion of said claim for refund.

(k) During the calendar year 1939 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$55.00 a share. With respect to petitioner's ownership of shares of stock and voting trust certificates, as aforesaid, petitioner reported the receipt of said distributions on her income tax return (Form 1040) for the calendar year 1939 as follows: On line 2 (included in the sum of \$1,751.48), as dividends received directly on 2 shares, the sum of \$110.00; and one line 7, as income distributed by the voting trustees, the sum of \$27,340.12, representing dividends received on 498 shares in the amount of \$27,390.00 less expenses in the amount of \$49.88. Petitioner also reported on line 7 of said return, as income received from said Claus

Spreckels Trust, the amount of \$29,426.45, which amount, due to the deduction of expenses, is somewhat less than petitioner's fractional interest in the distributions received from said J. D. and A. B. Spreckels Company by said trust. Petitioner filed said income tax return for the calendar year 1939 on March 14, 1940.

(1) On March 11, 1943, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1939 in the amount of \$7,324.66. Said claim for refund was based on the ground that no portion of said cash distributions in the total amount of \$56,876.57 received by petitioner during the calendar year 1939 from J. D. and A. B. Spreckels Company, either directly or indirectly, was paid out of the earnings or profits of J. D. and A. B. Spreckels Company for the taxable year 1939, nor out of the earnings or profits of said corporation accumulated after February 28, 1913, and that said distributions were not subject to income tax. The Commissioner has failed to allow any portion of said claim for refund.

(m) During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$68.00 a share. Petitioner received directly on 2 shares the sum of \$136.00 and received as income distributed by the voting trustees the sum of \$33,814.12, representing dividends received by said voting trustees on 498 shares in the amount of \$33,864.00 less expenses in the amount of \$49.88. Petitioner excluded 82% of said distributions on her income tax return (Form

1040) for the calendar year 1940 as non-taxable distributions and reported \$6,111.02 representing the remaining 18% thereof (18% of \$33,950.12) on line 2 as dividends received. Petitioner received during the calendar year 1940 from said Claus Spreckels Trust the sum of \$36,413.65, which amount, due to the deduction of expenses, was somewhat less than petitioner's fractional interest in the distributions received from said J. D. and A. B. Spreckels Company by said trust. Petitioner excluded approximately 82% of said amount as non-taxable income and reported approximately 18% thereof, namely, \$6,319.76, on line 7 of her said income tax return as received from said Claus Spreckels Trust.

(n) The Commissioner has erroneously increased petitioner's dividend income reported on line 2 of her said return by the amount of \$27,839.10 and has erroneously increased petitioner's fiduciary income reported on line 7 of her return by the amount of \$30,093.89. The total of said adjustments in the amount of \$57,932.99 represents approximately 82% of the distributions received by petitioner, either directly or indirectly, from J. D. and A. B. Spreckels Company during the calendar year 1940 and which petitioner did not report on the ground that such part of said distributions constituted non-taxable distributions as aforesaid.

(o) Petitioner alleges that only a portion of said cash distributions in the sum of \$82,648.60 received by petitioner, either directly or indirectly, during the calendar year 1937 from J. D. and A. B.

Spreckels Company, to wit: the sum of not more than \$59,075.58, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of earnings or profits for the calendar year 1937, and that the balance of said sum of \$82,648.60, to wit: an amount not less than the sum of \$23,573.02 was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1937, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(p) Petitioner alleges that no part of said cash distributions in the sum of \$45,635.28 received by petitioner, either directly or indirectly, during the calendar year 1938 from J. D. and A. B. Spreckels Company was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of earnings or profits for the calendar year 1938, and that said cash distributions were not subject to income tax in the hands of and were not taxable to petitioner.

(q) Petitioner alleges that only a portion of said cash distributions in the sum of \$56,876.57 received by petitioner, either directly or indirectly, during the calendar year 1939 from J. D. and A. B. Spreckels Company, to wit: the sum of not more than \$31,176.32, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1939, and that the balance of said sum of \$56,876.57, to wit: an amount not less than

the sum of \$25,700.25, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1939, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(r) Petitioner alleges that only a portion of said cash distributions in the sum of \$70,363.77 received by petitioner, either directly or indirectly, during the calendar year 1940 from J. D. and A. B. Spreckels Company, to wit: the sum of not more than \$14,219.11, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1940, and that the balance of said sum of \$70,363.77, to wit: an amount not less than the sum of \$56,144.66, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1940 and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(s) Petitioner is informed and believes, and therefore alleges, that on January 1, 1937, J. D. and A. B. Spreckels Company had no earnings or profits accumulated since March 1, 1913, that its earnings or profits for the calendar years 1937, 1938, 1939 and 1940 did not exceed the amounts set forth below, and that the distributions to its stockholders made by said corporation during said years were as follows:

Year	Earnings or Profits	Distributions
1937.....	\$1,072,164.11	\$1,500,000.00
1938.....(Loss)	1,313,516.91	850,000.00
1939.....	602,954.70	1,100,000.00
1940.....	274,827.56	1,360,000.00

(t) The basis to petitioner on January 1, 1937, for income tax purposes, of each share of the capital stock of J. D. and A. B. Spreckels Company, and of each share of said stock represented by voting trust certificates, held by said petitioner during the calendar years 1937, 1938, 1939 and 1940 was greater than the aggregate cash distributions made by said corporation during said four year period on each of said shares. The basis to said Claus Spreckels Trust on January 1, 1937, for income tax purposes, of each share of said stock represented by voting trust certificates held by said trust during the calendar years 1937, 1938, 1939 and 1940 was greater than the aggregate cash distributions made by said corporation during said four year period on each of said shares.

(u) Petitioner paid to Morrison, Hohfeld, Foerster, Shuman & Clark the sum of \$1,200 during each of the years 1937, 1938, 1939 and 1940 for investment counsel and for the maintenance of her financial records.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that petitioner is entitled to a refund of income taxes paid for the calendar year 1937 in the amount of at least \$10,436.63; that petitioner is entitled to a refund of

income taxes paid for the calendar year 1938 in the amount of at least \$5,723.26; that petitioner is entitled to a refund of income taxes paid for the calendar year 1939 in the amount of at least \$7,324.66; and that the deficiency in income taxes for the calendar year 1940 does not exceed \$83.36.

/s/ LEON de FREMERY,  
Counsel for Petitioner.

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State of California,  
County of Los Angeles—ss.

Ellis M. Moore, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, and is familiar with the statements contained therein, that the statements contained therein are true, except those stated to be upon information and belief, and those she believes to be true.

/s/ ELLIS M. MOORE.

Subscribed and sworn to before me this 28th day of June, 1944.

[Seal] /s/ HARRIETT R. BARKER,  
Notary Public.

My commission expires January 26, 1946.

EXHIBIT A

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street  
San Francisco 5, California

Office of  
Internal Revenue Agent in Charge  
San Francisco Division

IRA:90-D-LB  
(C:TS:PD  
SF:WGW)

May 26, 1944

Mrs. Ellis M. Moore  
1110 Crocker Building  
San Francisco, California

Dear Mrs. Moore:

You are advised that the determination of your income tax liability for the taxable years 1937, 1938, 1939 and 1940 discloses a deficiency of \$36,508.15 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are

requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco 5, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

JOSEPH D. NUNAN, JR.,

Commissioner,

By F. M. HARLESS,

Internal Revenue Agent in

Charge.

HJB

Enclosures:

Statement

Form of waiver.

## Statement

San Francisco  
(C:TS:PD  
SF:WGW)

Mrs. Ellis M. Moore  
1110 Crocker Building  
San Francisco, California

Tax Liability for the Taxable Years Ended December 31, 1937 to  
December 31, 1940, Inclusive

Year	Income Tax		
	Liability	Assessed	Deficiency
1937.....	\$27,535.98	\$20,546.60	\$ 6,989.38
1938.....	8,998.25	5,723.26	3,274.99
1939.....	13,500.92	10,756.30	2,744.62
1940.....	24,215.62	716.46	23,499.16
Totals .....	<hr/> \$74,250.77	<hr/> \$37,742.62	<hr/> \$36,508.15

In making this determination of your income tax liability, careful consideration has been given to your protests dated January 21, 1943, and March 24, 1943, and to the statements made at the conferences held on March 16, 1943, March 17, 1943, April 30, 1943, February 15, 1944, and February 23, 1944. Consideration has also been given to your claims for refund filed on March 14, 1941, covering 1937 in the amount of \$20,546.60; February 28, 1942, covering 1938 in the amount of \$5,723.26 and March 11, 1943, covering 1939 in the amount of \$7,324.66.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issue set forth in your claims for refund should be made a part of the petition to be considered by the Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with existing internal revenue laws.

A copy of this letter and statement has been mailed to your representative, Mr. Leon de Fremery, 1110 Crocker Building, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

You contend that your share of distributions by J. D. and A. B. Spreckels Company, a corporation, in which you owned stock directly and in which, trusts of which you were a beneficiary owned stock, is not taxable as a dividend in the year 1938, and that your share in the years 1937, 1939 and 1940 is taxable in part only. In the years 1937, 1938 and 1939 you reported the distributions as taxable income. In the year 1940 you reported only 18 per cent as taxable. It is held that

the distributions are out of earnings and profits accumulated after February 28, 1913, and are taxable as dividends in their entirety.

You contend that an oral agreement was entered into between yourself and your husband prior to your marriage on October 20, 1936, whereby it was agreed that your husband's income from his personal services would be his separate property. On August 31, 1939, a written agreement to that effect was signed by you and your husband. Information at hand indicates that during your marriage the matter of signing such an agreement was discussed and that for a considerable period of time you were reluctant to enter into a written agreement whereby you would waive your rights to the community income. In your income tax return for the year 1936, one-half of your husband's income from services from the time of your marriage to the end of the year, was returned by you and none was returned in the following years, separate returns having been filed in each year. It is held that one-half of your husband's income from services for the years 1937, 1938, and up to August 31, 1939, is includable in your taxable income.

#### Adjustments to Net Income

Year: 1937

Net income as disclosed by return.....	\$78,911.61
Unallowable deductions and additional income:	
(a) Community share of husband's partnership income.....	13,078.99
Net income adjusted.....	\$91,990.60

#### Explanation of Adjustments

(a) The distributive share of your husband, Dr. E. C. Moore, in the income less expenses of the Moore White Clinic, a partnership, for the year 1937, amounted to \$26,157.98 as shown by the separate return of your husband. In accordance with the preliminary statement herein it is held that one-half of your husband's income from services or \$13,078.99 is includable in your taxable income.

(b) Credit of \$105.40 for interest on Government obligations is allowed against the income subject to normal tax.

(c) Your allowable earned income credit is computed as follows:  
 Husband's partnership income, fully earned..... \$26,157.98  
 Your one-half share—earned income..... \$13,078.99  
 Earned income credit allowable (10 per cent of \$13,078.99)..... \$ 1,307.90

Computation of Tax  
Year: 1937

Net income adjusted .....	\$91,990.60
Less: Personal exemption .....	\$2,500.00
Credit for dependent .....	400.00
	2,900.00
Balance (surtax net income).....	\$89,090.60
Less: (b) Interest on U. S. obligations.....	\$ 105.40
(c) Earned income credit .....	1,307.90
	1,413.30
Net income subject to normal tax.....	\$87,677.30
Normal tax at 4 per cent on \$87,677.30.....	\$ 3,507.09
Surtax on	
\$89,090.60.....	24,036.21
Total tax .....	\$27,543.30
Less: Income tax paid at the source.....	7.32
Correct income tax liability.....	\$27,535.98
Income tax assessed: Original, account No. 203144—	
First California District .....	20,546.60
Deficiency of income tax.....	\$ 6,989.38

Adjustments to Net Income  
Year: 1938

Net income as disclosed by return.....	\$39,241.46
Unallowable deductions and additional income:	
(a) Community share of husband's partnership income.....	11,571.79
Net income adjusted.....	\$50,813.25

## Explanation of Adjustments

(a) There is added to your taxable income \$11,571.79, representing your 50 per cent community share of \$23,143.58, the distributive income derived by your husband, Dr. E. C. Moore, from the Moore-White Clinic, a partnership, as shown by his separate return.

(b) Your allowable earned income credit is computed as follows:

Husband's partnership income, 100 per cent earned.....	\$23,143.58
Your one-half community share—earned income.....	\$11,571.79
Earned income credit (10 per cent of \$11,571.79).....	\$ 1,157.18

## Computation of Alternative Tax Year: 1938

(Section 117 (c)—Revenue Act of 1938)

Adjustments to Net Income  
Year: 1939

Net income as disclosed by return.....	\$55,983.28
Unallowable deductions and additional income:	
(a) Community share of husband's partnership income.....	7,381.38
Net income adjusted .....	\$63,364.66

Explanation of Adjustments

(a) There is added to your taxable income \$7,381.38 your 50 per cent community share of the distributive income of your husband, Dr. E. C. Moore, from the Moore-White Clinic, a partnership, for the period from January 1, 1939, to August 31, 1939, in accordance with the preliminary statement herein. Your reportable share is computed as follows:

Distributive income, Moore-White Clinic, for year 1939.....	\$26,323.35
Less: expenses .....	6,407.85
Net .....	\$19,915.50
Earned during period January 1 to August 31, 1939.....	\$14,762.76
Your 50 per cent community share.....	\$ 7,381.38

(b) Earned income credit is allowed as follows:	
Your share of distribution from partnership for the period	
January 1, 1939, to August 31, 1939—earned income.....	\$ 7,381.38

Earned income credit (10 per cent of \$7,381.38).....	\$ 738.14
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Computation of Tax

Year: 1939

Net income adjusted.....	\$63,364.66
Less: Personal exemption .....	\$2,500.00
Credit for dependent .....	400.00
	2,900.00
Balance (surtax net income).....	\$60,464.66
Less: Interest on U. S. obligations.....	\$ 107.49
(b) Earned income credit .....	738.14
	845.63
Net income subject to normal tax.....	\$59,619.03
Normal tax at 4 per cent on \$59,619.03.....	\$ 2,384.76
Surtax on	
\$60,464.66.....	11,122.63
Total tax .....	\$13,507.39
Less: Income tax paid at the source.....	6.47
Correct income tax liability.....	\$13,500.92
Income tax assessed: Original, account No. 203069—	
First California District .....	10,756.30
Deficiency of income tax.....	\$ 2,744.62

Adjustments of Net Income  
Year: 1940

Net income as disclosed by return.....	\$11,714.27
Unallowable deductions and additional income:	
(a) Dividends .....	\$27,839.10
(b) Fiduciary income .....	30,404.37
(c) Other deductions .....	3.08
	<hr/>
Net income adjusted .....	\$69,960.82

Explanation of Adjustments

(a) Dividends in the amount of \$33,950.12 were received direct by you from the J. D. and A. B. Spreckels Company, of which only \$6,112.02 (\$6,111.02) or 18 per cent was reported on your return. The balance of \$27,839.10 is added to your taxable net income in accordance with the holding in the preliminary statement herein, that the distributions received by you in 1940 from this corporation were taxable as earnings dividends to the extent of 100 per cent.

(b) Your distributive share of taxable income from the following trusts is increased by \$30,404.37 as follows:

	As Revised	Reported	Increase
1. Claus Spreckels Trust .....	\$36,512.72	\$6,319.76	\$30,192.96
2. Ellis M. Spreckels Trust .....	276.20	64.79	211.41
<b>Totals .....</b>	<b>\$36,788.92</b>	<b>\$6,384.55</b>	<b>\$30,404.37</b>

1. The income of the Claus Spreckels Trust is revised as follows:	
Total distributive income as shown on the trust return.....	\$51,174.98
Add: Portion of trustee's fees disallowed as applicable to exempt income.....	138.32
	<hr/>

Revised distributive income .....	\$51,313.30
Your distributive share—23/32 .....	\$36,881.08
Less: Your share of exempt interest on U. S. obligations, 23/32 of \$512.50.....	368.36

Your distributive share of taxable income as revised.....	\$36,512.72
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The trust return on Form 1041, reported dividends received from J. D. and A. B. Spreckels Company as 100 per cent taxable and also included the total dividends from this source as income to be distributed to the beneficiaries.

While the trust return reported your distributive share of trust income to be \$36,413.65, you reported only \$6,319.76 of such income on your individual return, and made the explanation that you considered the amount of dividends included therein from the J. D. and A. B. Spreckels Company as being 18 per cent taxable instead of 100 per cent taxable as reported by the trust. As set forth in the preliminary statement, it is held that such dividends are taxable to the extent of 100 per cent.

2. Income from the Ellis M. Spreckels Trust is revised as follows:

Net distributive income as shown on the trust return..... \$ 92.54

Add: Portion of trustee's fees disallowed as

applicable to exempt income ..... 302.04

Revised distributive income ..... \$394.58

Your distributive share, 70 per cent. ..... \$276.20

(c) The deduction of \$70.58 investment expenses is reduced by an amount of \$3.08 held to be allocable to tax exempt income and non-deductible under section 24(a)(5) of the Internal Revenue Code.

#### Computation of Alternative Tax

Year: 1940

#### (Section 117 (c)—Internal Revenue Code)

Net income ..... \$69,960.82

Minus: Net long term capital gain ..... 1,883.07

Ordinary net income ..... \$68,077.75

Less: Personal exemption ..... \$2,000.00

Credit for dependent ..... 400.00 2,400.00

Balance (surtax net income) ..... \$65,677.75

Less: Interest on Government obligations, etc....\$ 212.11

Earned income credit ..... 300.00 512.11

Net income subject to normal tax ..... \$65,165.64

Normal tax at 4 per cent on \$65,165.64 ..... \$ 2,606.63

Surtax on ..... \$65,677.75 ..... 18,848.54

Partial tax ..... \$21,455.17

Plus: 30 per cent of net long-term gain ..... 564.92

Alternative tax ..... \$22,020.09

Computation of Tax  
 Year: 1940

Net income adjusted .....	\$69,960.82
Less: Personal exemption .....	\$2,000.00
Credit for dependent .....	400.00
	2,400.00
Balance (surtax net income) .....	\$67,560.82
Less: Interest on U. S. obligations.....	\$ 212.11
Earned income credit .....	300.00
	512.11
Net income subject to normal tax.....	\$67,048.71
Normal tax at 4 per cent on \$67,048.71.....	\$ 2,681.95
Surtax on	\$67,560.82
	19,733.59
Total tax (ordinary rates) .....	\$22,415.54
Alternative tax .....	\$22,020.09
Add: 10 per cent defense tax.....	2,202.01
Total tax .....	\$24,222.10
Less: Income tax paid at the source.....	6.48
Correct income tax liability.....	\$24,215.62
Income tax assessed: Original, account No. 856204—	
First California District .....	716.46
Deficiency of income tax.....	\$23,499.16

Received and filed July 5, 1944, T.C.U.S.

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 [Title of Tax Court and Cause.]  
 Docket No. 5495.

## ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits that the taxes in controversy are income taxes for the calendar years 1937, 1938, 1939, and 1940; denies all other allegations contained in paragraph 3 of the petition.
4. (a) to (f), inclusive. Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 and subparagraphs (a) to (f), inclusive, thereunder of the petition.
5. (a) Admits the allegations contained in subparagraph (a) of paragraph 5 of the petition.  
(b) Denies the allegations contained in subparagraph (b) of paragraph 5 of the petition.  
(c) Admits that the Commissioner has added to petitioner's income for the calendar year 1937 the sum of \$13,078.99 alleged to be petitioner's community share of her husband's partnership income, as alleged in subparagraph (c) of paragraph 5 of the petition; denies that such action was erroneous.  
(d) Admits that the Commissioner has added to petitioner's income for the calendar year 1938 the sum of \$11,571.79 alleged to be petitioner's community share of her husband's partnership income, as alleged in subparagraph (d) of paragraph 5 of the petition; denies that such action was erroneous.  
(e) Admits that the Commissioner has added to

petitioner's income for the calendar year 1939 the sum of \$7,381.38 alleged to be petitioner's community share of her husband's partnership income for the period January 1 to August 31, 1939, as alleged in subparagraph (e) of paragraph 5 of the petition; denies that such action was erroneous.

(f) Admits that during the calendar years 1937, 1938, 1939, and 1940 petitioner owned shares of capital stock of J. D. and A. B. Spreckels Company and trust certificates representing shares of capital stock of said corporation; admits that during the years 1937, 1938, 1939, and 1940 petitioner was the beneficiary of a trust known as the Claus Spreckels Trust, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive income from said trust during said years; admits that included in the assets of said trust during each of said years were trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; for lack of information and belief denies all remaining allegations contained in subparagraph (f) of paragraph 5 of the petition.

(g) Admits that during the calendar year 1937 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that with respect to petitioner's ownership of shares of stock and trust certificates she reported the receipt of certain of said distributions on her income tax return (Form 1040) for the calendar year 1937, which return was filed on March 15, 1938; for lack of information and belief denies all other allegations

contained in subparagraph (g) of paragraph 5 of the petition.

(h) Admits that on March 14, 1941, petitioner filed a claim for refund (Form 843) of income taxes for the calendar year 1937 in the amount of \$20,546.60 and that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief denies all other allegations contained in subparagraph (h) of paragraph 5 of the petition.

(i) Admits that during 1938 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that with respect to petitioner's ownership of shares of stock and trust certificates she reported the receipt of certain of said distributions on her income tax return (Form 1040) for the calendar year 1938, which return was filed on March 15, 1939; for lack of information and belief denies all other allegations contained in subparagraph (i) of paragraph 5 of the petition.

(j) Admits that on February 28, 1942, petitioner filed a claim for refund (Form 843) of income taxes for the calendar year 1938 in the amount of \$5,723.26 and that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief denies all other allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Admits that during the calendar year 1939 J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that with respect to petitioner's ownership of shares of stock and

trust certificates she reported the receipt of certain of said distributions on her income tax return (Form 1040) for the calendar year 1939; for lack of information and belief denies all other allegations contained in subparagraph (k) of paragraph 5 of the petition.

(l) Admits that on March 11, 1943, petitioner filed a claim for refund (Form 843) of income taxes for the calendar year 1939 in the amount of \$7,324.66 and that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief denies all other allegations contained in subparagraph (l) of paragraph 5 of the petition.

(m) Admits that during the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders and that petitioner excluded portions of said distributions from her income tax return (Form 1040) for the calendar year 1940; admits that petitioner received during the calendar year 1940 from said Claus Spreckels Trust distributions which had been received by said trust from said J. D. and A. B. Spreckels Company; admits that portions of said distribution were excluded by the petitioner from her income tax return for said year; for lack of information and belief denies all other allegations contained in subparagraph (m) of paragraph 5 of the petition.

(n) Admits that the Commissioner has increased petitioner's dividend income reported on line 2 of her 1940 return by the amount of \$27,839.10 and has increased petitioner's fiduciary income reported

on line 7 of her said return by the amount of \$30,-093.89 but denies that such actions were erroneous; for lack of information and belief denies all other allegations contained in subparagraph (n) of paragraph 5 of the petition.

(o), (p), (q), (r), and (s) denies all allegations contained in subparagraphs (o), (p), (q), (r), and (s) of paragraph 5 of the petition.

(t) and (u) for lack of information and belief denies all allegations contained in subparagraphs (t) and (u) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ **J. P. WENCHEL,**  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

**B. H. NEBLETT,**  
Division Counsel.

**T. M. MATHER,**  
**ARTHUR L. MURRAY,**  
Special Attorneys,  
Bureau of Internal Revenue.

Received and filed July 26, 1944 T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5495

### SUPPLEMENTARY STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled case, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

1. It is agreed that during the calendar years 1937 and 1938 respondent did not err in including in petitioner's income subject to tax for said years one-half of her husband's income from a professional partnership, of which he was a member, and in finding that for said years said income was community income and taxable to petitioner. The parties agree that for the period January 1 to August 31, 1939 respondent erred in including in petitioner's income subject to tax for said period one-half of her husband's income from said professional partnership, and it is agreed that no part of said income for said period is to be included in petitioner's taxable income.

2. It is agreed that during each of the calendar years 1937, 1938, 1939 and 1940 petitioner incurred expenses in the amount of \$1,200.00 and that of this amount \$600.00 per year is to be allowed petitioner

as a deduction for expenses incurred in the production or collection of income or for the management, conversion or maintenance of property held for the production of income.

3. Petitioner at all times during the calendar years 1938, 1939 and 1940 owned directly and in her own name 2 shares of the capital stock of J. D. and A. B. Speckels Company and voting trust certificates representing 498 shares of the capital stock of said company. Petitioner received from said company distributions on said shares in the following amounts:

Schedule A

Year	From Shares in Her Own Name	From Shares Covered by Voting Trust Certificate	Total
1/ 1/38 to 12/15/38.....	\$ 60.00	\$14,940.00	\$15,000.00
12/22/38 .....	25.00	6,225.00	6,250.00
<hr/> Total 1938 .....	\$ 85.00	\$21,165.00	\$21,250.00
1939 .....	110.00	27,390.00	27,500.00
1940 .....	136.00	33,864.00	34,000.00

At all times during the calendar years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Claus Spreckels Trust, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive 26/32 of the income of said trust for the period January 1 to and including September 26, 1938, and was entitled to receive 23/32 of the income of said trust for the period September 27 to December 31, 1938, and during the calendar years 1939 and 1940. Included in the assets of said trust during each of said years

were voting trust certificates representing 752 shares of the capital stock of J. D. and A. B. Spreckels Company. The distributions received by the trustee from said company were, under the terms of the trust, after deducting certain prior charges and expenses of the trust, currently distributable to the beneficiary. During said years the trustee made distributions as required by the terms of the trust and petitioner received from the trustee as petitioner's net share of said distributions of J. D. and A. B. Spreckels Company on said 752 shares the following amounts:

Schedule B

Year	Net Distribution by Trustees	J. D. and A. B. Spreckels Company	Net Bal. of Other Items
1/ 1/38 to 12/15/38		\$17,801.25	
12/22/38 to 12/31/38		6,756.25	
		<hr/>	
1938 Total .....	\$24,435.17	\$24,557.50	(\$122.33)
1939 .....	29,426.45	29,727.50	(\$301.05)
1940 .....	36,881.44	36,754.00	\$127.44

The parties are agreed that the portions of the dividends of J. D. and A. B. Spreckels Company for the years 1938, 1939 and 1940 which this Court determines in the case of Grace H. Kelham, Petitioner vs. Commissioner of Internal Revenue, Respondent, Docket No. 5333, have been paid out of capital will represent: (a) The portions of the respective amounts listed in the "Total" column of Schedule A which are to be subtracted from the petitioner's taxable income for the respective years; and (b) the portions of the respective amounts listed in the column entitled "J. D. and A. B. Spreckels Com-

pany Dividends" of Schedule B which are to be subtracted from the respective amounts listed in the column entitled "Net Distributions by Trustee" of Schedule B in determining petitioner's taxable income for the years 1938, 1939 and 1940.

Dated this 31st day of October, 1947.

/s/ LEON de FREMERY,  
Attorney for Petitioner.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

Filed at hearing Nov. 3, 1947 T.C.U.S.

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The Tax Court of the United States,  
Washington

Docket No. 5495

ELLIS M. MOORE,  
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

## DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated December 20, 1949, the respondent herein filed a computation of tax on February 28, 1950, and the petitioner on the same date

filed an acquiescence in the respondent's computation. In accordance therewith it is

Ordered and Decided: That for the year 1937 there is an over-payment in income tax of \$3,287.37, which amount was paid after the mailing of the notice of deficiency;

That for the year 1938 there is an over-payment in income tax of \$1,375.20, which amount was paid after the mailing of the notice of deficiency;

That for the year 1939 there is an over-payment of \$10,914.38, a portion of which amount was paid within three years before the filing of a claim for refund and the remainder was paid after the mailing of the notice of deficiency;

That for the year 1940 there is an over-payment in income tax of \$28,739.45, which amount was paid after the mailing of the notice of deficiency.

Enter:

[Seal]      /s/ BOLON B. TURNER,  
                    Judge.

Entered Mar. 14, 1950.

Served Mar. 15, 1950.

In the United States Court of Appeals  
For the Ninth Circuit  
T. C. Docket No. 5495

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,  
vs.  
ELLIS M. MOORE,  
Respondent on Review.

**PETITION FOR REVIEW**

To the Honorable Judges of the United States  
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by the Tax Court of the United States on March 14, 1950, that there are overpayments of income tax for the years 1939 and 1940 in the respective amounts of \$10,914.38 and \$28,739.45 in respect of the Federal income tax liability of Ellis M. Moore, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Ellis M. Moore, is a resident of California whose mailing address is 1110 Crocker Building, San Francisco, California. Respondent's Federal income tax returns for the calendar year 1939 and 1940, the taxable years here in-

volved, were filed with the Collector of Internal Revenue for the First District of California, whose office is located in San Francisco, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

### Nature of Controversy

During the calendar years 1938, 1939 and 1940 the respondent on review was the owner of 2 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 498 shares of the capital stock of said company, in respect of which shares she received during the years 1938, 1939 and 1940 distributions in the respective amounts of \$21,250.00, \$27,500.00 and \$34,000. The respondent was also the beneficiary of a trust among the assets of which trust were voting trust certificates representing 752 shares of the capital stock of J. D. and A. B. Spreckels Company. As a part of her share of the distributable income of said trust for the years 1938, 1939 and 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company in 1938, 1939 and 1940 on said 752 shares, the respective sums of \$24,557.50, \$29,727.50 and \$36,754.00. In her Federal income tax returns for the years 1939 and 1940 the respondent returned taxable income the amounts so received in 1939 but only \$6,112.02 in 1940 in respect of the shares and voting trust certificates of J. D. and A. B. Spreckels Company owned directly

by her and only \$6,319.76 in respect of her share of distributions made to the trust. The distributions received by the respondent in 1938 were reported as taxable income in her 1938 income tax return and there is now no dispute in respect thereof. In his determination of the respondent's tax liability for the year 1940 the Commissioner increased the distributions returned by the respondent to their full amounts.

It was the taxpayer's contention before the Tax Court of the United States, among other things, that in determining the percentages or amounts of the distributions made by the J. D. and A. B. Spreckels Company which represented taxable dividends in the hands of the recipients thereof it is necessary to first restore out of subsequent earnings and profits the pre-March 1, 1913, accumulated operating losses, or deficit, of the predecessor of J. D. and A. B. Spreckels Company and its affiliated companies. The Commissioner contended, on the other hand, that operating deficits as of March 1, 1913, may not be restored by subsequent earnings and profits in determining the amount of earnings or profits accumulated after February 28, 1913, which would constitute taxable dividends to the recipients in whole or in part. The Tax Court of the United States disagreed with the Commissioner's determination and allowed the restoration of pre-March 1, 1913, accumulated operating losses for the purpose of determining the amount of subsequent earnings and profits available for distribution as taxable dividends, as a result of which allowances the over-

payments of tax for the years 1939 and 1940 partly resulted.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of Internal Revenue, At-  
torneys for Petitioner on Review.

Received and filed June 2, 1950, T.C.U.S.

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The Tax Court of the United States  
Docket No. 5559

HARRIET H. BELCHER,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:PB) dated April 22, 1944, and as a basis of her proceeding alleges as follows:

1. Petitioner is an individual, whose mailing address is c/o The First National Trust and Savings Bank, San Diego, California. The return for the period here involved was filed with the Collector of

## Internal Revenue for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on April 22, 1944.

3. The taxes in controversy are income taxes for the calendar year 1940 and in the amount of \$1,471.00.

4. The determination of tax set forth in said notice of deficiency is based on the following error:

(a) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1940 were paid out of earnings or profits to the extent of 100% thereof and as a result of said determination increasing petitioner's income by the amount of \$31,950.48; and the Commissioner erred in failing to find that at least 79.792% of said distributions were not paid out of earnings or profits.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) During the calendar year 1940 petitioner was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive one-half of the income of said trust for the calendar year 1940. Included in the assets of said trust during the period January 1 to and including October 9, 1940, were voting trust certificates representing 1146

shares of the capital stock of J. D. and A. B. Spreckels Company. Included in the assets of said trust during the period October 10 to and including December 31, 1940, were voting trust certificates representing 1237 shares of the capital stock of J. D. and A. B. Spreckels Company.

(b) During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$68.00 a share, of which \$22.50 a share was paid during the period January 1 to October 9, 1940, and \$42.50 a share was paid during the period October 10 to December 31, 1940.

(c) Said Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, received from said distributions the sum of \$82,068.50 less voting trustees' expenses in the sum of \$114.79, or \$81,953.71, and on its fiduciary return for the calendar year 1940 reported said sum in full as taxable income. Said return showed income distributable to petitioner in the amount of \$42,124.27, which amount included petitioner's one-half interest in said distributions in the amount of \$81,953.71, or the sum of \$40,976.85.

(d) Petitioner reported on line 7 of her income tax return (Form 1040) for the calendar year 1940, as income received from fiduciaries, the sum of \$13,789.84, of which amount the sum of \$10,173.79 was reported as having been received from said Trust No. 1173, Crocker First National Bank of San Francisco, Trustee.

(e) The difference between said sum of \$42,-

124.27 reported on said fiduciary return as taxable income distributable to petitioner and said sum of \$10,173.79 reported by petitioner as having been received from said fiduciary, namely, \$31,950.48, represents that part of petitioner's one-half portion of the dividends received by said fiduciary from J. D. and A. B. Spreckels Company during the calendar year 1940, which petitioner eliminated from taxable income as not having been paid out of the earnings or profits of said corporation. The Commissioner has erroneously increased petitioner's fiduciary income received from Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, by said amount of \$31,950.48.

(f) Petitioner alleges that only a portion of said cash distributions in the amount of \$40,976.85 received by petitioner during the calendar year 1940 from J. D. and A. B. Spreckels Company through the medium of said Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, to wit: the sum of not more than \$8,280.60, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1940, and that the balance of said sum of \$40,976.85, to wit: an amount not less than the sum of \$32,696.25, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the taxable year 1940, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(g) Petitioner is informed and believes and therefore alleges that on January 1, 1940, J. D. and A. B. Spreckels Company had no earnings or profits accumulated since March 1, 1913, and that its earnings or profits for the calendar year 1940 did not exceed \$274,827.56. During the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$1,360,000.00.

(h) The basis to said Lillie S. Wegeforth Trust, No. 1173, Crocker First National Bank of San Francisco, Trustee, on January 1, 1940, for income tax purposes, of each share of the capital stock of J. D. and A. B. Spreckels Company represented by voting trust certificates held by said trust during the calendar year 1940 was greater than the aggregate cash distributions made by said corporation during said calendar year 1940 on each share of said stock.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that there is no deficiency in income tax due from petitioner for the calendar year 1940.

/s/ LEON de FREMERY,  
Counsel for Petitioner.

State of California,  
County of San Diego—ss.

Harriet H. Belcher, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, and is familiar with the statements contained

therein, that the statements contained therein are true, except those stated to be upon information and belief, and those she believes to be true.

/s/ HARRIET H. BELCHER.

Subscribed and sworn to before me this 7th day of July, 1944.

[Seal]      /s/ R. N. CHAMBERLIN,  
                    Notary Public.

My Commission Expires Nov. 25, 1945.

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### EXHIBIT A

Treasury Department  
Internal Revenue Service  
417 South Hill Street,  
Los Angeles 13, California

Office of  
Internal Revenue Agent in Charge  
Los Angeles Division  
LA:IT:90D:PB

Apr. 22, 1944.

Mrs. Harriet H. Belcher  
c/o First National Trust and Savings Bank  
San Diego, California

Dear Mrs. Belcher:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1940 discloses a deficiency of \$1,471.00, as shown in the statement attached.

In accordance with the provisions of existing

internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,  
Commissioner,

By /s/ GEORGE D. MARTIN,  
Internal Revenue Agent in  
Charge.

Enclosures:

Statement

Form of waiver

## Statement

LA:IT:90D:PB

Mrs. Harriet H. Belcher,  
c/o First National Trust and Savings Bank  
San Diego, California

## Tax Liability for the Taxable Year Ended December 31, 1940

	Liability	Assessed	Deficiency
Income Tax .....	\$1,471.00	None	\$1,471.00

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated May 10, 1943, to your protest dated June 25, 1943, and to the statements made at the conferences held on February 15 and February 23, 1944.

A copy of this letter and statement has been mailed to your representative, Mr. Leon de Fremery, 1110 Crocker Building, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you.

## Adjustments to Net Income

Net income (loss) as disclosed by return..... (\$17,956.59)

## Additional income:

(a) Income from trust .....

32,435.80

Total .....

\$14,479.21

## Additional deduction:

(b) Contributions .....

546.30

Net income adjusted .....

\$13,932.91

## Explanation of Adjustments

(a) Income of Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, taxable to you has been increased as follows:

1. Dividends received .....

\$31,950.48

2. Trustee's fees disallowed .....

485.32

Total.....

\$32,435.80

1. You are the beneficial owner of shares of stock of J. D. and A. B. Spreckels Company. You contend that your distributive share of the distributions by said corporation in the year 1940 is taxable as dividends to the extent of only 18 per cent. It is held that the distributions are out of earnings and profits accumulated after February 28, 1913, and are taxable as dividends in their entirety.

2. This amount of trustee's fees is disallowed as being allocable to exempt income. Section 24(a)(5) of the Internal Revenue Code.

(b) In view of the above addition to income the contributions listed in your return in the amount of \$546.30, not claimed as a deduction, are allowed as a deduction.

## Computation of Tax

Net income adjusted .....	\$13,932.91
Less: Personal exemption (claimed by husband) .....	None
Balance (surtax net income) .....	\$13,932.91
Less: Earned income credit .....	300.00
Net income subject to normal tax .....	\$13,632.91
Normal tax at 4% on \$13,632.91 .....	\$545.32
Surtax on \$13,932.91 .....	791.95
Total normal tax and surtax .....	\$ 1,337.27
Defense tax (10% of \$1,337.27) .....	133.73
Total income tax .....	\$ 1,471.00
Correct income tax liability .....	\$ 1,471.00
Income tax assessed: Original, account No. 728078 .....	None
Deficiency of income tax .....	\$ 1,471.00

Received and filed July 17, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5559.

## ANSWER.

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the determination of tax set forth in the notice of deficiency is based upon error as alleged in paragraph 4 and subparagraph (a) thereof of the petition.

5. (a) Admits that during the calendar year 1940 petitioner was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive income of said trust for the calendar year 1940; admits that included in the assets of said trust during the period January 1 to and including October 9, 1940, were voting trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company, and that included in the assets of said trust during the period October 10 to and including December 31, 1940, were voting trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; for lack of information and belief denies all other allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that during the calendar year 1940 J. D. and A. B. Spreckels Company made distributions to its shareholders; for lack of information and belief denies all other allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits that said Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, re-

ceived certain of said distributions; for lack of information and belief denies all other allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) Admits that petitioner reported on line 7 of her income tax return (Form 1040) for the calendar year 1940, as income received from fiduciaries, the sum of \$13,789.84; for lack of information and belief denies all other allegations contained in subparagraph (d) of paragraph 5 of the petition.

(e), (f), (g), and (h). Denies the allegations contained in subparagraphs (e), (f), (g), and (h) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

T. M. MATHER,  
ARTHUR L. MURRAY,  
Special Attorneys,  
Bureau of Internal Revenue.

Received and filed Sept. 4, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5559.

### SUPPLEMENTARY STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled case, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

Petitioner at all times during the calendar year 1940 was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive one-half of the income of said trust for the calendar year 1940. Included in the assets of said trust during the period January 1 to and including October 9, 1940, were voting trust certificates representing 1,146 shares of the capital stock of J. D. and A. B. Spreckels Company. Included in the assets of said trust during the period October 10 to and including December 31, 1940, were voting trust certificates representing 1,237 shares of the capital stock of J. D. and A. B. Spreckels Company. Distributions received by the trustee from said company were, under the terms of the trust, after deducting certain prior charges and expenses of the trust, cur-

rently distributable to the beneficiaries. During the year 1940 petitioner received indirectly through said trust dividends from J. D. and A. B. Spreckels Company in the amount of \$41,034.25.

The parties are agreed that the portion of the dividends of J. D. and A. B. Spreckels Company for the year 1940 which this Court determines in the case of Grace H. Kelham, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 5333, has been paid out of capital will represent the portion of the amount of \$41,034.25 which is to be subtracted from said amount in determining petitioner's taxable income for the year 1940.

Dated this 31st day of October, 1947.

/s/ LEON de FREMERY,  
Attorney for Petitioner.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

Filed at hearing Nov. 3, 1947, T. C. U. S.

The Tax Court of the United States, Washington  
Docket No. 5559

HARRIET H. BELCHER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated December 20, 1949, the respondent herein filed a computation of tax on February 28, 1950, and the petitioner on the same date filed an acquiescence in the respondent's computation. In accordance therewith it is

Ordered and Decided: That there is no deficiency in income tax for the year 1940.

Enter:

[Seal]      /s/ BOLON B. TURNER,  
                    Judge.

Entered Mar. 14, 1950.

Served Mar. 15, 1950.

In the United States Court of Appeals  
for the Ninth Circuit  
T. C. Docket No. 5559

COMMISSIONER OF INTERNAL REVENUE,

Petitioner on Review,

vs.

HARRIET H. BELCHER,

Respondent on Review.

**PETITION FOR REVIEW**

To the Honorable Judges of the United States Court  
of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby  
petitions the United States Court of Appeals for  
the Ninth Circuit to review the decision entered by  
The Tax Court of the United States on March 14,  
1950, "That there is no deficiency in income tax for  
the year 1940" in respect of the Federal income tax  
liability of Harriet H. Belcher, the above-named  
respondent on review. This petition for review is  
filed pursuant to the provisions of Sections 1141 and  
1142 of the Internal Revenue Code.

The respondent on review, Harriet H. Belcher,  
is a resident of California whose mailing address  
is c/o The First National Trust and Savings Bank,  
San Diego, California. Respondent's Federal in-  
come tax return for the calendar year 1940, the  
taxable year here involved, was filed with the Col-

lector of Internal Revenue for the Sixth District of California, whose office is located in Los Angeles, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

### Nature of Controversy

During the taxable year 1940 the respondent on review was the beneficiary of a trust among the assets of which trust were voting trust certificates representing 1,146 shares of the capital stock of J. D. and A. B. Spreckels Company during the period January 1 to and including October 9, 1940, and voting trust certificates representing 1,237 shares of the capital stock of said company during the period October 10, 1940, to and including December 31, 1940. As a part of her share of the distributable income of said trust for the year 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company in 1940 on said shares, the sum of \$41,034.25. In her Federal income tax return for the year 1940 the respondent returned as taxable income only \$10,173.79 of the distributable income of the trust, which amount included or reflected only approximately 18 per cent of her share of distributions made to the trust by the J. D. and A. B. Spreckels Company. In his redetermination of the respondent's tax liability for the year 1940 the Commissioner increased the distributions returned by the respondent to their full amounts.

It was the taxpayer's contention before The Tax Court of the United States, among other things, that in determining the percentages or amounts of the distributions made by the J. D. and A. B. Spreckels Company which represented taxable dividends in the hands of the recipients thereof it is necessary to first restore out of subsequent earnings and profits the pre-March 1, 1913, accumulated operating losses, or deficit, of the predecessor of J. D. and A. B. Spreckels Company and its affiliated companies. The Commissioner contended, on the other hand, that operating deficits as of March 1, 1913, may not be restored by subsequent earnings and profits in determining the amount of earnings or profits accumulated after February 28, 1913, which would constitute taxable dividends to the recipients in whole or in part. The Tax Court of the United States disagreed with the Commissioner's determination and allowed the restoration of pre-March 1, 1913, accumulated operating losses for the purpose of determining the amount of subsequent earnings and profits available for distribution as taxable dividends.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed June 2, 1950, T.C.U.S.

The Tax Court of the United States  
Docket No. 5560

LILLIE S. WEDGEFORTH,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

### PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:PB) dated May 13, 1944, and as a basis of her proceeding alleges as follows:

1. Petitioner is an individual, whose mailing address is c/o The First National Trust and Savings Bank of San Diego, San Diego, California. The returns for the periods here involved were filed with the Collector for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on May 13, 1944.

3. The taxes in controversy are income taxes for the calendar years 1938, 1939 and 1940, and in the following amounts:

Year	Deficiency Asserted	Overpayment Claimed	Amount in Controversy
1938.....	\$ 711.19	\$15,578.82	\$16,290.01
1939.....	1,069.75	32,427.63	33,497.38
1940.....	80,032.58	.....	79,238.56

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1938 were paid out of earnings or profits to the extent of 100% thereof; and the Commissioner erred in failing to find that no portion of said distributions were paid out of earnings or profits, and in failing to allow in full petitioner's claim for refund of income taxes paid for the calendar year 1938.

(b) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1939 were paid out of earnings or profits to the extent of 100% thereof; and the Commissioner erred in failing to find that at least 45.186% of said distributions were not paid out of earnings or profits, and in failing to allow to that extent petitioner's claim for refund of income taxes paid for the calendar year 1939.

(c) The Commissioner erred in determining that distributions made by J. D. and A. B. Spreckels Company to its stockholders during the calendar year 1940 were paid out of earnings or profits to the extent of 100% thereof and as a result of said determination increasing petitioner's income for the year 1940 by the amount of \$153,953.36; and the Commissioner erred in failing to find that at least

79.792% of said distributions were not paid out of earnings or profits.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) During the calendar years 1938, 1939 and 1940 petitioner was the beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and as such beneficiary was entitled to receive the entire income of said trust during each of said years. Included in the assets of said trust during each of said years were 2 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 2,186 shares of the capital stock of said corporation.

(b) During the calendar years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive one-half of the income of said trust during each of said years. Included in the assets of said trust during the calendar years 1938 and 1939 and the period January 1 to and including October 9, 1940, were voting trust certificates representing 1,146 shares of the capital stock of J. D. and A. B. Spreckels Company. Included in the assets of said trust during the period October 10 to December 31, 1940, were voting trust certificates representing 1,237 shares of the capital stock of J. D. and A. B. Spreckels Company.

(c) During the calendar year 1938, J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$42.50 a share. Said trust, No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, received from said distributions the sum of \$92,990.00. Due to certain deductions taken by said trust on its income tax return for said year the distributable income reported by petitioner on line 7 of her income tax return (Form 1040) for the calendar year 1938 was the sum of \$79,761.47. Petitioner also reported on line 7 of her said return, as income received from said trust, No. 1173, Crocker First National Bank of San Francisco, Trustee, the sum of \$25,004.94, which sum included dividends received from J. D. and A. B. Spreckels Company in the sum of \$24,352.50. Petitioner filed said income tax return for the calendar year 1938 on March 15, 1939.

(d) On February 27, 1942, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1938 in the amount of \$15,578.82. Said claim for refund was based on the ground that no portion of said cash distributions made by J. D. and A. B. Spreckels Company during the calendar year 1938 was paid out of the earnings or profits of J. D. and A. B. Spreckels Company and that said distributions received by petitioner through the medium of said trust, No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and said trust, No. 1173, Crocker First National Bank of San Francisco, Trustee, were not subject to income tax. The Commissioner

has failed to allow any portion of said claim for refund.

(e) During the calendar year 1939, J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$55.00 a share. Petitioner reported the receipt of said distributions on line 7 of her income tax return (Form 1040) for the calendar year 1939 as follows: As income received from said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee (included in the sum of \$126,481.85) the amount of \$120,340.00 representing dividends on 2,188 shares; and as income received from said trust No. 1173, Crocker First National Bank of San Francisco, Trustee (included in the sum of \$32,358.33) the amount of \$31,515.00 representing dividends on 723 shares. Petitioner filed said income tax return for the calendar year 1939 on **March 15, 1940.**

(f) On February 12, 1943, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1939 in the amount of \$41,169.64. Said claim for refund was based on the ground that no portion of said cash distributions made by J. D. and A. B. Spreckels Company during the calendar year 1939 was paid out of the earnings or profits of J. D. and A. B. Spreckels Company and that said distributions received by petitioner through the medium of said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and said Trust No. 1173,

Crocker First National Bank of San Francisco, Trustee, were not subject to income tax. The Commissioner has failed to allow any portion of said claim for refund.

(g) During the calendar year 1940, J. D. and A. B. Spreckels Company made distributions to its stockholders in the amount of \$68.00 a share, of which \$22.50 a share was paid during the period January 1 to October 9, 1940, and \$45.50 a share was paid during the period October 10 to December 31, 1940.

(h) Said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, received from said distributions the sum of \$148,784.00 and on its fiduciary return for the calendar year 1940 excluded 82% thereof or \$122,002.88 as non-taxable distributions. The balance of said distributions in the amount of \$26,781.12 was reported on said return as taxable income. After deducting the excess in the sum of \$1,727.37 of expenses over other income, said return showed income distributable to petitioner in the amount of \$25,053.75, which petitioner reported on line 7 of her income tax return (Form 1040) for the calendar year 1940.

(i) Said trust No. 1173, Crocker First National Bank of San Francisco, Trustee, received from said distributions the sum of \$82,068.50 less voting trustees' expenses in the sum of \$114.79, or \$81,953.71, and on its fiduciary return for the calendar year 1940 reported said sum in full as taxable income. Said return showed income distributable to petitioner in the amount of \$42,124.27, which

amount included petitioner's one-half interest in said distributions in the amount of \$81,953.71, or the sum of \$40,976.85. From said distributable income in the amount of \$42,124.27, petitioner excluded \$31,950.48 as constituting non-taxable distributions and reported the remainder of said sum of \$42,124.27, or \$10,173.79, on line 7 of her said income tax return for the calendar year 1940 as income received from said trust No. 1173.

(j) The Commissioner has erroneously increased petitioner's fiduciary income received from trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, by the sum of \$122,002.88, and has erroneously increased petitioner's fiduciary income received from trust No. 1173, Crocker First National Bank of San Francisco, Trustee, by the amount of \$31,950.48. The total of said adjustments in the amount of \$153,953.36 represents that portion of the distributions received by said trust No. 5380 and said trust No. 1173 from J. D. and A. B. Spreckels Company during the calendar year 1940 which petitioner excluded from income on the ground that such distributions constituted non-taxable distributions as aforesaid.

(k) Petitioner alleges that no part of said cash distributions in the sum of \$92,990.00 received from J. D. and A. B. Spreckels Company by said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, during the calendar year 1938, and that no part of said cash distributions in the sum of \$48,705.00 received by said trust

No. 1173, Crocker First National Bank of San Francisco, Trustee, during the calendar year 1938, from J. D. and A. B. Spreckels Company, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of earnings or profits for the calendar year 1938. Petitioner alleges further that the entire distributable income of said trust No. 5380 in the amount of \$79,761.47 reported by petitioner on her income tax return as aforesaid, and the sum of \$24,332.50 (included in the sum of \$25,004.94) reported by petitioner as income received from said trust No. 1173, were not subject to income tax in the hands of and were not taxable to petitioner.

(1) Petitioner alleges that only a portion of said cash distributions in the sum of \$151,855.00 received by petitioner during the calendar year 1939 from J. D. and A. B. Spreckels Company through the medium of said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and trust No. 1173, Crocker First National Bank of San Francisco, Trustee, to wit: the sum of not more than \$83,237.80, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1939, and that the balance of said sum of \$151,855.00, to wit: an amount not less than the sum of \$68,617.20 was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the calendar year 1939, and that said

balance was not subject to income tax in the hands of and was not taxable to petitioner.

(m) During the calendar year 1940 said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, received from J. D. and A. B. Spreckels Company distributions in the sum of \$148,784.00 as aforesaid and after deducting the excess in the sum of \$1,727.37 of expenses over other income, as aforesaid, distributed to petitioner the sum of \$147,056.63. During the calendar year 1940 petitioner received from J. D. and A. B. Spreckels Company through the medium of trust No. 1173, Crocker First National Bank of San Francisco, Trustee, distributions in the amount of \$40,976.85 as aforesaid. Petitioner alleges that only a portion of said total cash distributions in the sum of \$188,033.48 received by petitioner during the calendar year 1940 from J. D. and A. B. Spreckels Company through the medium of said trust No. 5380 and said trust No. 1173, to wit: the sum of not more than \$37,997.81, was paid out of the earnings or profits of said corporation accumulated after February 28, 1913, or out of its earnings or profits for the calendar year 1940, and that the balance of said sum of \$188,033.48, to wit: an amount not less than the sum of \$150,035.67, was not paid out of the earnings or profits of said corporation accumulated after February 28, 1913, nor out of its earnings or profits for the calendar year 1940, and that said balance was not subject to income tax in the hands of and was not taxable to petitioner.

(n) Petitioner is informed and believes and

therefore alleges that on January 1, 1938, J. D. and A. B. Spreckels Company had no earnings or profits accumulated since March 1, 1913, that its earnings or profits for the calendar years 1938, 1939 and 1940 did not exceed the amounts set forth below, and that the distributions to its stockholders made by said corporation during said years were as follows:

Year	Earnings or Profits	Distributions
1938.....	(Loss) \$1,313,516.91	\$ 850,000.00
1939.....	602,954.70	1,100,000.00
1940.....	274,827.56	1,360,000.00

(o) The basis to said trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and said trust No. 1173, Crocker First National Bank of San Francisco, Trustee, of each share of the capital stock of J. D. and A. B. Spreckels Company, and of each share of said stock represented by voting trust certificates, held by said trusts during the calendar years 1938, 1939 and 1940 was greater than the aggregate cash distributions made by said corporation during said three-year period on each of said shares.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that petitioner is entitled to a refund of income taxes paid for the calendar year 1938 of at least \$15,578.82; that petitioner is entitled to a refund of income taxes paid for the calendar year 1939 of at least \$32,427.63; and that the deficiency in income tax for the calendar year 1940 does not exceed \$794.02.

/s/ LEON de FREMERY,  
Counsel for Petitioner.

State of California,  
County of San Diego—ss.

Lillie S. Wegeforth, being duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or had the same read to her, and is familiar with the statements contained therein, that the statements contained therein are true, except those stated to be upon information and belief, and those she believes to be true.

/s/ LILLIE S. WEGEFORTH.

Subscribed and sworn to before me this 10th day of July, 1944.

[Seal]      /s/ R. N. CHAMBERLIN,  
                    Notary Public.

My Commission Expires Nov. 25, 1945.

## EXHIBIT A

Treasury Department  
Internal Revenue Service  
417 South Hill Street  
Los Angeles 13, California

Office of  
Internal Revenue Agent in Charge  
Los Angeles Division  
LA:IT:90D:PB

May 13, 1944

Mrs. Lillie S. Wegeforth

c/o The First National Trust and Savings Bank of  
San Diego,  
San Diego, California

Dear Mrs. Wegeforth:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1937, to 1940, inclusive, discloses a deficiency of \$81,813.52 for the taxable years ended December 31, 1938, 1939 and 1940, and an overassessment of \$600.01 for the taxable year ended December 31, 1937, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United

States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,  
Commissioner.

By /s/ RAYMON B. SULLIVAN,  
Acting Internal Revenue  
Agent in Charge.

PB:vmc

Enclosures:

Statement

Form of waiver.

## Statement

LA:IT:90D:PB

Mrs. Lillie S. Wegeforth  
c/o The First National Trust

and Savings Bank of San Diego  
San Diego, California

Tax Liability for the Taxable Years Ended  
December 31, 1938, 1939 and 1940  
Income Tax

Year	Liability	Assessed	Overassessment	Deficiency
1937.....	\$ 68,460.20	\$ 69,060.21	\$600.01	
1938.....	16,290.01	15,578.82		\$ 711.19
1939.....	42,239.39	41,169.64		1,069.75
1940.....	80,993.39	960.81		80,032.58
Total .....	\$207,982.99	\$126,769.48	\$600.01	\$81,813.52

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated November 30, 1942, and May 10, 1943, to your claims for refund for the year 1937 filed on December 4, 1937, March 7, 1941, and February 27, 1942, to your claims for refund for 1938 and 1939 filed on February 27, 1942, and February 12, 1943, respectively, to your protests dated February 9 and June 25, 1943, and to the statements made at the conferences held.

You are the beneficial owner of shares of stock of J. D. and A. B. Spreekels Company. You contend that your distributive share of the distributions by said corporation in the year 1938 is not taxable and that your distributive share in the years 1939 and 1940 is taxable in part only. In the years 1937, 1938 and 1939 you reported the distributions as taxable income. In the year 1940, you reported only 18 per cent as taxable. It is held that the distributions are out of earnings and profits accumulated after February 28, 1913, and are taxable as dividends in their entirety.

You are the beneficiary of trusts which derive taxable income and tax exempt income. Expenses allocable to tax exempt income are found to be as follows:

	1937	1938	1939	1940
Trust #5380, First National Trust and Savings Bank of San Diego .....	\$ 485.07	\$ 592.78	\$ 657.31	\$ 779.87
Trust #P1173, Crocker First National Bank, San Fran- cisco .....	488.27	625.38	568.07	485.33
Trust #2356, Crocker First National Bank, San Fran- cisco .....	134.14	0	0	0
Total.....	\$1,107.48	\$1,218.16	\$1,225.38	\$1,265.20

The above-mentioned amounts are not deductible in computing trust income taxable to you. Section 24(a)(5) of the Revenue Acts of 1936 and 1938 and of the Internal Revenue Code.

If a petition to The Tax Court of the United States is filed against the deficiency proposed herein, the issue set forth in your claims for refund for the years 1938 and 1939 should be made a part of the petition to be considered by the Court in any redetermination of your tax liability. If a petition is not filed, the claims for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 of the Internal Revenue Code.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322(a) of the Revenue Act of 1936.

A copy of this letter and statement has been mailed to your representative, Mr. Leon F. de Fremery, 1110 Crocker Building, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income  
Taxable Year Ended December 31, 1937

Net income as disclosed by return.....	\$156,663.90
Additional income and unallowable deductions:	
(a) Trust income increased .....	\$1,107.48
(b) Partnership loss decreased .....	1,867.24
	2,974.72
Total .....	\$159,638.62
Reduction in income:	
(c) Mathematical error .....	3,165.12
Net income adjusted .....	\$156,473.50

Explanation of Adjustments

- (a) This adjustment has been previously explained.
- (b) Your distributive share of loss of the partnership Belbrook Stables has been determined to be \$19,644.86, in lieu of \$21,512.10 claimed.
- (c) Due to a mathematical error made in your return the \$2,592.09 capital gain reported is adjusted to a capital loss of \$573.03.

**Computation of Tax**  
**Taxable Year Ended December 31, 1937**

Net income adjusted .....	\$156,473.50
Less: Personal exemption.....	1,000.00
Balance (surtax net income).....	\$155,473.50
Less: Interest on U. S. obligations .....	\$ 269.83
Earned income credit .....	300.00
	569.83
Net income subject to normal tax.....	\$154,903.67
Normal tax at 4% on \$154,903.67.....	\$ 6,196.15
Surtax on                           \$155,473.50.....	62,284.10
Total income tax .....	\$ 68,480.25
Less: Income tax paid at source.....	20.05
Correct income tax liability.....	\$ 68,460.20
Income tax assessed:	
Original, account No. 204202.....	\$68,582.05
Deficiency, February, 1941, List, account No. 510211.....	478.16
Total income tax assessed.....	69,060.21
Overassessment of income tax.....	\$ 600.01

**Adjustments to Net Income**  
**Taxable Year Ended December 31, 1938**

Net income as disclosed by return.....	\$64,703.76
Additional income and unallowable deductions:	
(a) Trust income increased .....	\$1,218.16
(b) Contributions disallowed .....	295.00
	1,513.16
Net income adjusted .....	\$66,216.92

## Explanation of Adjustments

- (a) This adjustment has been previously explained.
- (b) The deduction of \$295.00 claimed as contribution to Coronado Horse Show is not allowable under the provisions of section 23(o) or 23(a) of the Revenue Act of 1938.

Computation of Alternative Tax  
Taxable Year Ended December 31, 1938

Net income adjusted .....	\$66,216.92
Plus: Net long-term capital loss .....	5,235.61
<hr/>	
Ordinary net income .....	\$71,452.53
Less: Personal exemption .....	1,000.00
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Balance (surtax net income).....	\$70,452.53
Less: Earned income credit .....	300.00
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Net income subject to normal tax.....	\$70,152.53
Normal tax at 4% on \$70,152.53.....	\$ 2,806.10
Surtax on \$70,452.53.....	15,054.59
<hr/>	
Partial tax .....	\$17,860.69
Minus: 30% of net long-term capital loss.....	1,570.68
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Alternative tax .....	\$16,290.01

Computation of Tax  
Taxable Year Ended December 31, 1938

Net income adjusted .....	\$66,216.92
Less: Personal exemption.....	1,000.00
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Balance (surtax net income).....	\$65,216.92
Less: Earned income credit .....	300.00
<hr/>	
Net income subject to normal tax.....	\$64,916.92
Normal tax at 4% on \$64,916.92.....	\$ 2,596.68
Surtax on \$65,216.92.....	12,914.60
<hr/>	
Total .....	\$15,511.28
Alternative tax .....	\$16,290.01
Correct income tax liability.....	\$16,290.01
Income tax assessed: Original, account No. 841692.....	15,578.82
<hr/>	
Deficiency of income tax.....	\$ 711.19

Adjustments to Net Income  
Taxable Year Ended December 31, 1939

Net income as disclosed by return.....	\$109,978.97
Additional income and unallowable deductions:	
(a) Trust income increased .....	\$1,225.38
(b) Contributions disallowed .....	500.00
	1,725.38
<hr/>	
Net income adjusted .....	\$111,704.35

## Explanation of Adjustments

- (a) This adjustment has been previously explained.
- (b) The deduction of \$500.00 claimed as a contribution to Coronado Horse Show is not allowable under the provisions of section 23(o) or 23(a) of the Internal Revenue Code.

**Computation of Alternative Tax  
Taxable Year Ended December 31, 1939**

**Computation of Tax**  
**Taxable Year Ended December 31, 1939**

Net income adjusted .....	\$111,704.35
Less: Personal exemption .....	1,000.00
Balance (surtax net income).....	\$110,704.35
Less: Earned income credit .....	300.00
Net income subject to normal tax.....	\$110,404.35
Normal tax at 4% on \$110,404.35.....	\$ 4,416.17
Surtax on                   \$110,704.35.....	36,788.52
<hr/>	
Total .....	\$ 41,204.69
Alternative tax .....	\$ 42,239.39
Correct income tax liability.....	\$ 42,239.39
Income tax assessed: Original, account No. 203835.....	41,169.64
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Deficiency of income tax.....	\$ 1,069.75

Adjustments to Net Income  
Taxable Year Ended December 31, 1940

Net income as disclosed by return.....	\$ 11,696.14
Additional income: (a) Trust income.....	155,218.56
<hr/>	
Total .....	\$166,914.70
Additional deduction: (b) Contributions.....	11,235.98
<hr/>	
Net income adjusted .....	\$155,678.72

Explanation of Adjustments

(a) This represents additional income from trusts as follows:  
Trust #5380:

Dividends received from J. D. and

A. B. Spreckels Company .....	\$153,953.36
Disallowable expenses .....	779.87
<hr/>	

Total .....	\$154,733.23
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Trust #1173:

Disallowable expenses .....	485.33
<hr/>	
Total .....	\$155,218.56

These adjustments have been previously explained.

(b) In view of the above adjustments the entire amount of \$13,300.00 listed in your return as contributions paid is deductible, in lieu of \$2,064.02 claimed in your return.

Computation of Alternative Tax  
Taxable Year Ended December 31, 1940

Net income adjusted .....	\$155,678.72
Minus: Net long-term capital gain.....	3,705.99
<hr/>	
Ordinary net income .....	\$151,972.73
Less: Personal exemption .....	800.00
<hr/>	
Balance (surtax net income).....	\$151,172.73
Less: Earned income credit .....	300.00
<hr/>	
Net income subject to normal tax.....	\$150,872.73
Normal tax at 4% on \$150,872.73.....	\$ 6,034.91
Surtax on \$151,172.73.....	66,483.64
<hr/>	
Partial tax .....	\$ 72,518.55
Plus: 30% of net long-term capital gain.....	1,111.80
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Alternative tax .....	\$ 73,630.35

**Computation of Tax**  
**Taxable Year Ended December 31, 1940**

Net income adjusted .....	\$155,678.72
Less: Personal exemption .....	800.00
Balance (surtax net income).....	\$154,878.72
Less: Earned income credit.....	300.00
Net income subject to normal tax.....	\$154,578.72
Normal tax at 4% on \$154,578.72.....	\$ 6,183.15
Surtax on                           \$154,878.72.....	68,707.23
Total normal tax and surtax.....	\$ 74,890.38
Alternative tax .....	\$ 73,630.35
Defense tax (10% of \$73,630.35).....	7,363.04
Correct income tax liability.....	\$ 80,993.39
Income tax assessed : Original, account No. 879298.....	960.81
Deficiency of income tax.....	\$ 80,032.58

Received and filed July 17, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5560

## ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar years 1938, 1939 and 1940; denies all other allegations contained in paragraph 3 of the petition.

4. (a) to (c), inclusive. Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 and subparagraphs (a) to (c), inclusive, thereunder, of the petition.

5. (a) Admits that during the calendar years 1938, 1939 and 1940 petitioner was the beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 5380, the First National Trust and Savings Bank of San Diego, Trustee, and as such beneficiary was entitled to receive the entire income of said trust during each of said years; admits that included in the assets of said trust during each of said years were shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing shares of the capital stock of said corporation; for lack of information and belief denies all other allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that during the calendar years 1938, 1939 and 1940 petitioner was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive income of said trust during each

of said years; admits that included in the assets of said trust during the calendar years 1938 and 1939 and the period January 1 to and including October 9, 1940, were voting trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; admits that included in the assets of said trust during the period October 10 to December 31, 1940, were voting trust certificates representing shares of the capital stock of J. D. and A. B. Spreckels Company; for lack of information and belief denies all other allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits that during the calendar year 1938, J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that petitioner filed an income tax return for the calendar year 1938 on March 15, 1939; for lack of information and belief denies all other allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) Admits that on February 27, 1942, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1938 in the amount of \$15,578.82; admits that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief denies all other allegations contained in subparagraph (d) of paragraph 5 of the petition.

(e) Admits that during the calendar year 1939, J. D. and A. B. Spreckels Company made distributions to its stockholders; admits that petitioner filed an income tax return for the calendar year

1939 on March 15, 1940; for lack of information and belief denies all other allegations contained in subparagraph (e) of paragraph 5 of the petition.

(f) Admits that on February 12, 1943, petitioner filed a claim for refund (Form 843) of income taxes paid for the calendar year 1939 in the amount of \$41,169.64; admits that the Commissioner has failed to allow any portion of said claim for refund; for lack of information and belief denies all other allegations contained in subparagraph (f) of paragraph 5 of the petition.

(g) Admits that during the calendar year 1940, J. D. and A. B. Spreckels Company made distributions to its stockholders; for lack of information and belief denies all other allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h) Admits that said Trust No. 5380, The First National Bank and Savings Bank of San Diego, Trustee, received some of said distributions; for lack of information and belief denies all other allegations contained in subparagraph (h) of paragraph 5 of the petition.

(i) Admits that said Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, received some of said distributions; for lack of information and belief denies all other allegations contained in subparagraph (i) of paragraph 5 of the petition.

(j), (k) and (l) Denies the allegations contained in subparagraphs (j), (k) and (l) of paragraph 5 of the petition.

(m) Admits that during the calendar year 1940

said Trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, received from J. D. and A. B. Spreckels Company certain distributions; admits that during the calendar year 1940 petitioner received from J. D. and A. B. Spreckels Company through the medium of Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, certain distributions; denies all other allegations contained in subparagraph (m) of paragraph 5 of the petition.

(n) and (o) Denies the allegations contained in subparagraphs (n) and (o) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel.

T. M. MATHER,  
ARTHUR L. MURRAY,  
Special Attorneys,  
Bureau of Internal Revenue.

Received and filed Sept. 4, 1944, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 5560

### SUPPLEMENTARY STIPULATION OF FACTS

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true upon the trial of the above-entitled case, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true.

Petitioner at all times during the calendar years 1938, 1939 and 1940 was the beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 5380, The First National Trust and Savings Bank of San Diego, Trustee, and as such beneficiary was entitled to receive the entire income of said trust during each of said years. Included in the assets of said trust during each of said years were 2 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 2,186 shares of the capital stock of said company. The distributions received by the trustee from said company were, under the terms of the trust, after deducting certain prior charges and expenses, currently distributable to the beneficiary. During said calendar years 1938, 1939 and 1940 the trustee made distributions as required by the terms of the trust and petitioner received from the trustee as petitioner's net share of said distribu-

tions of J. D. and A. B. Spreckels Company on said shares the following amounts:

Schedule A

Year	Net Distribution by Trustees	J. D. and A. B. Spreckels Company	Net Bal. of Other Items
1/ 1/38 to 12/15/38		\$65,640.00	
12/22/38		27,350.00	
 Total 1938 .....	\$74,525.86	\$92,990.00	(\$18,464.14)
1939 .....	121,435.95	120,340.00	1,095.95
1940 .....	150,762.62	148,784.00	1,978.02

Petitioner at all times during the calendar years 1938, 1939 and 1940 was a beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, Crocker First National Bank of San Francisco, Trustee, and as such beneficiary was entitled to receive one-half of the income of said trust for said years. Included in the assets of said trust during the period January 1, 1938, to and including October 9, 1940, were voting trust certificates representing 1,146 shares of the capital stock of J. D. and A. B. Spreckels Company. Included in the assets of said trust during the period October 10 to and including December 31, 1940, were voting trust certificates representing 1,237 shares of the capital stock of J. D. and A. B. Spreckels Company. Distributions received by the trustee from said company were, under the terms of the trust, after deducting certain prior charges and expenses of the trust, currently distributable to the beneficiaries. During said years the trustee made distributions as required by the terms of the trust and petitioner received from the trustee as peti-

tioner's net share of the said distributions of J. D. and A. B. Spreckels Company the following amounts:

## Schedule B

Year	Net Distribution by Trustees	J. D. and A. B. Spreckels Company Dividends	Net Bal. of Other Items
1/ 1/38 to 12/15/38		\$17,190.00	
12/22/38		7,162.50	
<hr/>			
Total 1938 .....	\$25,004.94	\$24,352.50	\$ 652.44
1939 .....	32,358.33	31,515.00	843.33
1940 .....	42,124.27	41,034.25	1,090.02

The parties are agreed that the portions of the dividends of J. D. and A. B. Spreckels Company for the years 1938, 1939 and 1940 which this Court determines in the case of Grace H. Kelham, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 5333, have been paid out of capital will in the case of this petitioner represent the portions of the respective amounts listed in the column entitled "J. D. and A. B. Spreckels Company Dividends" of Schedules A and B which are to be subtracted from the respective amounts listed in the columns entitled "Net Distributions by Trustees" of Schedules A and B in determining petitioners' taxable income for the years 1938, 1939 and 1940.

Dated this 31st day of October, 1947.

/s/ LEON de FREMERY,

Attorney for Petitioner.

--  
/s/ CHARLES OLIPHANT,

Chief Counsel, Bureau of  
Internal Revenue.

Filed at hearing Nov. 3, 1947, T.C.U.S.

The Tax Court of The United States  
Washington  
Docket No. 5560

LILLIE S. WEGEFORTH,  
Petitioner,  
vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated December 20, 1949, the respondent herein filed a computation of tax on February 28, 1950, and the petitioner on the same date filed an acquiescence in the respondent's computation. In accordance therewith it is

Ordered and Decided: That for the year 1938 there is a deficiency in income tax of \$711.19;

That for the year 1939 there is an over-payment in income tax of \$33,821.09, which amount was paid within three years before the filing of a claim for refund;

That for the year 1940 there is a deficiency in income tax of \$1,321.03.

Enter:

[Seal] /s/ BOLON B. TURNER,  
Judge.

Entered March 14, 1950.

Served March 15, 1950.

In the United States Court of Appeals  
for the Ninth Circuit  
T. C. Docket No. 5560

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner on Review,

vs.

LILLIE S. WEGEFORTH,  
Respondent on Review.

### PETITION FOR REVIEW

To the Honorable Judges of the United States  
Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 14, 1950, that there is an overpayment of income tax in the amount of \$33,821.09 for the year 1939 and a deficiency in income tax for the year 1940 in the amount of \$1,321.03 in respect of the Federal income tax liability of Lillie S. Wegeforth, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Lillie S. Wegeforth, is a resident of California, whose mailing address is c/o The First National Trust and Savings Bank of San Diego, San Diego, California. Respondent's

Federal income tax returns for the calendar years 1939 and 1940, the taxable years here involved, were filed with the Collector of Internal Revenue for the Sixth District of California, whose office is located in Los Angeles, California, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

### Nature of Controversy

During the calendar years 1938, 1939 and 1940 the respondent on review was the beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 5380, among the assets of which trust were 2 shares of the capital stock of J. D. and A. B. Spreckels Company and voting trust certificates representing 2,186 shares of the capital stock of said company. As a part of the distributable income of said trust for the years 1938, 1939 and 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company in 1938, 1939 and 1940 on said 2,188 shares, the respective sums of \$92,990.00 (less \$18,464.14 representing other items), \$120,340.00 and \$148,784.00.

Respondent was also the beneficiary of a trust known as the Lillie S. Wegeforth Trust, Trust No. 1173, among the assets of which trust during the period January 1, 1938, to and including October 9, 1940, were voting trust certificates representing 1,146 shares of the capital stock of J. D. and A. B. Spreckels Company, and included in the assets of which trust during the period October 10, 1940, to

and including December 31, 1940, were voting trust certificates representing 1,237 shares of the capital stock of J. D. and A. B. Spreckels Company. As a part of the distributable income of said latter trust for the years 1938, 1939 and 1940, the respondent received from the trustees, as her net share of distributions made to the trust by the J. D. and A. B. Spreckels Company in 1938, 1939 and 1940 on said shares, the respective sums of \$24,352.50, \$31,515.00 and \$41,034.25. In her Federal income tax returns for the years 1938 and 1939 the respondent returned the amounts so received during those years, but in her return for 1940 the respondent returned as taxable income only 18 per cent in respect of the distributions made to the trusts by the J. D. and A. B. Spreckels Company. In his redetermination of the respondent's tax liability for the year 1940 the Commissioner increased the distributions returned by the respondent to their full amounts.

It was the taxpayer's contention before The Tax Court of the United States, among other things, that in determining the percentages or amounts of the distributions made by the J. D. and A. B. Spreckels Company which represented taxable dividends in the hands of the recipients thereof it is necessary to first restore out of subsequent earnings and profits the pre-March 1, 1913, accumulated operating losses, or deficit, of the predecessor of J. D. and A. B. Spreckels Company and its affiliated companies. The Commissioner contended, on the other hand, that operating deficits as of March 1, 1913, may not be restored by subsequent earn-

ings and profits in determining the amount of earnings or profits accumulated after February 28, 1913, which would constitute taxable dividends to the recipients in whole or in part. The Tax Court of the United States disagreed with the Commissioner's determination and allowed the restoration of pre-March 1, 1913, accumulated operating losses for the purpose of determining the amount of subsequent earnings and profits available for distribution as taxable dividends, as a result of which allowances the overpayment of tax for the year 1939 and the reduced deficiency in tax for the year 1940 partly resulted.

There is now no dispute in respect of the tax liability for the year 1938 in so far as this petition for review is concerned.

/s/ THERON L. CAUDLE,  
Assistant Attorney General.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed June 2, 1950, T.C.U.S.

## [Titles of Causes.]

T. C. Docket Nos. 5333, 5334, 5495, 5559 and 5560.

## CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 76, inclusive, constitute and are all of the original papers and proceedings on file in my office as the original and complete record in the proceedings before The Tax Court of the United States entitled: "Grace H. Kelham, Leila H. Neill, Ellis M. Moore, Harriet H. Belcher, Lillie S. Wegeforth, Petitioners, vs. Commissioner of Internal Revenue, Respondent," Docket Nos. 5333, 5334, 5495, 5559, 5560, respectively, and in which the respondents in The Tax Court proceedings have initiated appeals as above numbered and entitled, together with true copies of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 11th day of August, 1950.

[Seal]      /s/ VICTOR S. MERSCH,  
Clerk, The Tax Court  
of the United States.

[Endorsed]: No. 12664. United States Court of Appeals for the Ninth Circuit. Commisisoner of Internal Revenue, Petitioner, vs. Grace H. Kelham, Leila H. Neill, Ellis M. Moore, Harriett H. Belcher, and Lillie S. Wegeforth, Respondents. Transcript of the Record. Upon Petitions to Review Decisions of The Tax Court of the United States.

Filed August 25, 1950.

/s/PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

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In the United States Court of Appeals  
for the Ninth Circuit  
No. 12664

COMMISSIONER OF INTERNAL REVENUE,  
Petitioner,

vs.

GRACE H. KELHAM, LEILA H. NEILL, ELLIS  
M. MOORE, HARRIET H. BELCHER,  
LILLIE S. WEGEFORTH,  
Respondents.

Tax Court Docket Nos. 5333, 5334, 5495, 5559 and  
5560

#### STIPULATION

It is hereby stipulated by the parties, subject to  
the approval of the Court, that the above-entitled

cases may be consolidated for the purposes of the record, briefs, argument and decision.

/s/ THERON LAMAR CAUDLE,  
Assistant Attorney General, Counsel for the Com-  
missioner.

/s/ LEON de FREMERY,  
Counsel for taxpayers.

Approved: October 24, 1950.

/s/ WILLIAM DENMAN,

/s/ WILLIAM HEALY,

/s/ HOMER BONE,

Judges, U. S. Court of Ap-  
peals for the Ninth Circuit.

[Endorsed]: Filed Oct. 26, 1950 U.S.C.A.

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[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS TO BE RELIED ON  
AND DESIGNATION OF PORTIONS OF  
THE RECORD TO BE PRINTED

Pursuant to Rule 19, Paragraph 6, Rules of the Court of Appeals for the Ninth Circuit, the following statement is made of the points on which the Commissioner intends to rely in the above-entitled cases:

The Tax Court erred in holding, under Section 115 of the Internal Revenue Code and of the applicable revenue acts, that earnings and profits of a

corporation accumulated after February 28, 1913, available for the distribution of taxable dividends, must be computed in such a manner that, where a deficit in earnings and profits existed on March 1, 1913, subsequent earnings and profits must first be applied to removing the deficit before there can be a surplus in such accumulated earnings and profits, and in failing to hold, under Section 115 of the Internal Revenue Code and of the applicable revenue acts, that the earnings and profits of a corporation accumulated after February 28, 1913, are to be computed without regard to any deficit in earnings and profits existing on March 1, 1913.

Pursuant to the same rule of the Court, the following designation is made of the portions of the record in the above-entitled cases which are considered material to the issue to be presented on review and which the Commissioner desires to have incorporated in the printed record:

Document No. 1—Docket Entries in Tax Court No. 5333.

Document No. 12—Stipulation of Facts Re Dividend Issue in Tax Court Nos. 5333, 5334, 5495, 5559, 5560.

Document No. 13—Supplementary Stipulation of Facts in Tax Court No. 5333.

Document No. 36—Supplementary Stipulation of Facts in Tax Court No. 5334.

Document No. 48—Supplementary Stipulation of Facts in Tax Court No. 5495.

Document No. 59—Supplementary Stipulation of Facts in Tax Court No. 5559.

Document No. 70—Supplementary Stipulation of Facts in Tax Court No. 5560.

Document No. 23—Opinion of Tax Court, together with concurring opinion of Judge Tyson and dissenting opinion of Judge Disney in Tax Court Nos. 5333, 5334, 5495, 5559, and 5560.

Document No. 25—Decision in Tax Court No. 5333.

Document No. 38—Decision in Tax Court No. 5334.

Document No. 50—Decision in Tax Court No. 5495.

Document No. 61—Decision in Tax Court No. 5559.

Document No. 72—Decision in Tax Court No. 5560.

/s/ THERON LAMAR CAUDLE,  
Assistant Attorney General, Counsel for the Com-  
missioner.

[Endorsed]: Filed Nov. 2, 1950 U.S.C.A.

